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

Administrative Proceedings Rulings
Release No. 5636 / February 28, 2018

Administrative Proceeding
File No. 3-17849

In the Matter of

Angel Oak Capital Partners, LLC,
Peraza Capital & Investment, LLC,
Sreeniwas Prabhu, and
David W. Wells

Order on Motion for Summary Disposition

Summary

Respondent Peraza Capital & Investment, LLC, admitted to causing Respondent Angel Oak Capital Partners, LLC's,[1] violations of Section 15(a) of the Securities Exchange Act of 1934 for acting as an unregistered broker-dealer. The case was assigned to me to decide whether it is appropriate to order disgorgement, prejudgment interest, or civil penalties against Peraza. I grant the Division of Enforcement's motion for summary disposition in part, and find that (1) the disgorgement and civil penalties being sought by the Division are not barred by 28 U.S.C. § 2462's statute of limitations and (2) Peraza's receipt of commissions was causally connected to the violations at least to some degree, for disgorgement purposes. I otherwise deny the motion. Further briefing or evidence is required on certain issues before I decide whether to award monetary sanctions.

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[1] Throughout this order, "Angel Oak" refers to Angel Oak Capital Partners. When I refer instead to Angel Oak Capital Advisors, LLC, I will note the change.

Procedural Background

On February 16, 2017, the Securities and Exchange Commission, having accepted offers of settlement from all Respondents in this proceeding, issued an order instituting proceedings (OIP) pursuant to Exchange Act Sections 15(b) and 21C as to Angel Oak, and pursuant to Exchange Act Section 21C as to the other three Respondents. In the OIP, the Commission: (1) found that Angel Oak violated Exchange Act Section 15(a); (2) found that the other three Respondents caused Angel Oak's violation; (3) ordered Respondents to cease and desist from committing or causing any violations and any future violations of Exchange Act Section 15(a); (4) censured Angel Oak; (5) ordered Angel Oak, Sreeniwas Prabhu, and David W. Wells to pay civil penalties, and Angel Oak to pay disgorgement; and (6) ordered that further proceedings be held before an administrative law judge to decide whether it is appropriate to order disgorgement, prejudgment interest, or civil penalties against Peraza. OIP at 8-10.

I granted leave for the parties to file motions for summary disposition on the issue of Peraza's liability for disgorgement, prejudgment interest, and civil penalties. *See* 17 C.F.R. § 201.250(c); *Angel Oak Capital Partners, LLC*, Admin. Proc. Rulings Release No. 4715, 2017 SEC LEXIS 963 (ALJ Mar. 28, 2017). On May 26, 2017, the Division submitted a motion for summary disposition against Peraza with an accompanying brief (Motion) and a declaration of counsel (Worland Decl.) with three exhibits, including a balance sheet identifying the amount Peraza received from Angel Oak's trading. Peraza opposed the Division's motion, and included a declaration (Katz Decl.) and four exhibits. The Division filed a reply with a declaration (Worland Reply Decl.) and seven additional exhibits, and Peraza filed a surreply. Oral argument (Tr.) was held on August 3, 2017. There I indicated that I would consider disgorgement on motion, but would reserve the matter of civil penalties for a hearing. Tr. 48. On September 6, 2017, the Division submitted a letter calling attention to a recent district court order it considered relevant to Peraza's legal objections to disgorgement. On September 22, 2017, Peraza submitted a letter attempting to distinguish the order cited by the Division.

Legal Standard

A motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(c). The facts on summary disposition must be viewed in the light most favorable to the nonmoving party. *See Jay T. Comeaux*, Securities Act Release No. 9633, 2014 WL 4160054, at *2 (Aug. 21, 2014). Once the moving party

has carried its burden of showing it is entitled to summary disposition on the factual record, the opposing party may not rely on bare allegations or denials, but must instead show that there is a genuine dispute of material fact that needs to be resolved by hearing. *Id.*

Facts

The OIP's allegations "shall be accepted as and deemed true by the hearing officer" in this proceeding, and Peraza is "precluded from arguing that it did not violate the federal securities laws described in [the OIP]." OIP at 9. Below, I recite the most relevant facts in the OIP. I also note undisputed facts found in "affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence." *Id.*

Peraza is a Florida corporation with its primary office in St. Petersburg, Florida, and has been a registered broker-dealer with the Commission since 2002. *Id.* at 4. Angel Oak Capital Partners, formed in 2008, is the general partner to Angel Oak Capital Advisors, LLC. *Id.* at 3-4. Angel Oak Capital Advisors is a registered investment adviser, but Angel Oak Capital Partners is not itself registered with the Commission in any capacity. *Id.*

Angel Oak wanted to operate a securities business, but did not know if it would be profitable enough to justify the expense of registering as a broker-dealer. *Id.* at 4. Instead, in October 2009, it signed an independent contractor agreement with Peraza allowing it to "conduct a securities business" through Peraza. *Id.* Pursuant to the agreement, Peraza established an office in Atlanta, Georgia, for the securities trading and designated it as a branch office. *Id.* at 2, 5. Peraza also provided Angel Oak with "all necessary back office support" for its "sales and trading activities," and provided Angel Oak a trading platform for its trades. *Id.* at 4-5. All trades were to be cleared and settled by Peraza's clearing firm. *Id.* at 5.

Wells, who is employed by Angel Oak Capital Advisors and was registered with Peraza and held Series 7 and 24 licenses during the relevant period, served as the branch manager and supervisor of the Atlanta office where Angel Oak Capital Partners conducted its activities. *Id.* at 4, 5, 7. Angel Oak employees involved in securities trading registered with FINRA as registered representatives of Peraza. *Id.* at 2, 5. In March 2010, these registered representatives began executing trades through Peraza's trading platform. *Id.* at 5. From March 2010 until October 2014, Angel Oak employees entered into more than 900 trades in this fashion. *Id.* at 2, 5.

During this period, Angel Oak "held itself out as a broker-dealer" despite being unregistered. *Id.* at 2. In soliciting customers and marketing its

securities business, employees often used the Angel Oak name, without always disclosing the company's relationship with Peraza. *Id.* at 2, 6. Trade confirmations provided to customers routinely indicated that Angel Oak was involved in the transaction. *Id.* at 6. In one marketing document, Angel Oak described itself as a "Full-Service Fixed Income Broker-Dealer." *Id.* Angel Oak received transaction-based compensation in connection with its trading activities. *Id.* at 2.

Moreover, Angel Oak and its owners—who were not all registered as broker-dealers—controlled aspects of the securities business, including hiring new employees to engage in trading, determining transaction-based compensation, and participating in discussions on how to operate the securities business. *Id.* at 6-8. For instance, Angel Oak made all relevant decisions regarding staffing of the securities business. When it hired new employees, the offer letters came from Angel Oak, and Angel Oak determined compensation, including salary, commission, and bonus. *Id.* at 6. Angel Oak also held regular internal meetings to discuss the securities business it was operating. *Id.* at 7. Angel Oak considered its trading activities part of the firm's securities business. *Id.*

Angel Oak violated Exchange Act Section 15(a) by operating as an unregistered broker-dealer from March 2010 to October 2014. *Id.* at 2-3, 8. Peraza caused Angel Oak's violations because it: (1) provided Angel Oak employees access to its trading platform, clearing firm arrangement, and trade support services; (2) allowed Angel Oak employees to register with it as licensed securities representatives; and (3) facilitated Angel Oak's receipt of transaction-based compensation. *Id.* at 8. Peraza facilitated Angel Oak's trading activities, even though it knew or should have known that Angel Oak's owners, who were not all registered as broker-dealers or associated with a registered broker-dealer, were controlling Angel Oak's securities business. *Id.* at 3, 8.

Peraza received commissions from Angel Oak's trading. *Id.* at 3, 6. Pursuant to the independent contractor agreement, Peraza retained fifteen percent of the commission revenue Angel Oak generated from its trading, and Angel Oak received the remainder. *Id.* at 2, 5. After trades were cleared through Peraza's clearing firm, Peraza deducted its fifteen percent share on a monthly basis. *Id.* at 5. From 2010 to 2014, Peraza's share totaled $1,521,705.87. Worland Decl. Ex. 2 (line item "Revenues less Commissions paid"); Worland Reply Decl. Ex. D at 46-47 (deposition of Xiomara Perez identifying line item "Revenues less Commissions paid" as Peraza's total share of the commissions from 2010 to 2014). After Peraza deducted its share, it paid the balance to the Atlanta branch; during most of the relevant period the money went to Wells. *See* OIP at 6. From 2010 to 2014, that amount

totaled $9,984,328.41. Worland Decl. Ex. 2 (line item "Commissions to ATL branch"); Worland Reply Decl. Ex. D at 46 (identifying the line item "Commissions to the Atlanta branch" as the commission dollars paid to the branch). Wells withheld his own share for trades he handled, and then paid out commission revenue due to other individual Angel Oak employees for their trading activities. OIP at 6. Finally, Wells typically paid the remaining balance to Angel Oak. *Id.* Angel Oak's commissions totaled approximately $3,054,288. *Id.* at 2, 6. The Commission ordered Angel Oak to disgorge that amount. *Id.* at 10.

Angel Oak, not Peraza, paid the clearinghouse charges for the trades it brokered. *See* Worland Reply Decl. Ex. E at 53-54 (deposition of David Wells). Additionally, Angel Oak provided the office space, supplies, computers, email, and access to Bloomberg services. OIP at 5.

The Commission's Office of Compliance Inspections and Examinations (OCIE) conducted an on-site inspection of Angel Oak Capital Advisors in December 2010 and January 2011. Katz Decl. Ex. C at 1. On September 12, 2011, OCIE informed Angel Oak Capital Advisors of its violation of Section 15(a), and asked it to follow up in thirty days about the steps it had taken or intended to take to resolve the violation. *Id.* at 1-2, 9.[2]

In late 2014, Angel Oak discontinued its arrangement with Peraza. OIP at 4 n.3.

Discussion

Statute of Limitations

Under 28 U.S.C. § 2462, "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." "[T]he 'standard rule' is that a claim accrues 'when the plaintiff has a complete and present cause of action.'" *Gabelli v. SEC*, 568 U.S. 442, 448 (2013) (quoting *Wallace v. Kato*, 549 U.S. 384, 388 (2007)). In *Kokesh v. SEC*, 137 S. Ct. 1635, 1643-44 (2017), the Supreme Court held that disgorgement is a penalty just like civil monetary penalties

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[2] Angel Oak Capital Advisors was registered as an investment adviser, but not as a broker-dealer. *See* OIP at 3-4. Peraza apparently considers OCIE's inspection to have applied to Angel Oak Capital Partners as well; it does not distinguish between the two Angel Oak entities in its brief. *See* Opp. at 6.

and "[t]he 5-year statute of limitations in § 2462 therefore applies when the SEC seeks disgorgement."

Peraza argues that the Division's entire claim for disgorgement and civil penalties is time-barred, having "first accrued" in March 2010 when Angel Oak began trading on Peraza's platform, which is outside § 2462's five-year limitations period. Opp'n at 7-14. According to Peraza, the Division had a "complete and present cause of action" under *Gabelli* "[a]t the moment when Peraza first split its transaction-based compensation with Angel Oak." *Id.* at 11. At the very least, after the inspection in late 2010 when the Division became aware of Angel Oak's activities, the Division could have brought an action. *Id.* at 13-14. In Peraza's view, because the Division failed to bring its claim within five years of the initial violation, any claim is now time-barred.

However, Peraza's argument fails to take into account that § 2462's application depends on the context. If wrongful acts committed within § 2462's five-year limitations period independently support a complete claim or claims, then the fact that wrongful acts also occurred outside the limitations period does not bar suit for acts that occurred within the limitations period. A contrary result would allow violators of securities laws to commit recurrent violations and find shelter under § 2462 if any portion of the violations occurred outside the limitations period. *See Birkelbach v. SEC*, 751 F.3d 472, 479 (7th Cir. 2014) (noting that viewing a failure to supervise over an extended period of time as "a single indivisible act which begins on the first day of unethical supervision . . . would be absurd," because "if an unethical supervisor were to avoid detection for five years, he could continue his unethical behavior forever without FINRA or the [Commission] being able to discipline him.").

Here, the underlying violation is unregistered broker activity in violation of Section 15(a), which makes it illegal for an unregistered broker or dealer "to effect *any* transactions in . . . any security." 15 U.S.C. § 78*o*(a) (emphasis added). Angel Oak held itself out as a broker throughout the March 2010 to October 2014 time period, entered into 900 trades during that period, regularly solicited customers and marketed its securities business, and received transaction-based compensation. OIP at 2; *see also James S. Tagliaferri*, Securities Act Release No. 4650, 2017 WL 632134, at *4 (Feb. 15, 2017) ("[A]ctivities that are indicative of being a broker include holding oneself out as a broker-dealer, recruiting or soliciting potential investors, handling client funds and securities, negotiating with issuers, and receiving transaction-based compensation" (quoting *Anthony Fields, CPA*, Investment Advisers Act of 1940 Release No. 4028, 2015 WL 728005, at *18 (Feb. 20, 2015))). Angel Oak did not simply violate Section 15(a) at a single point in time; it repeatedly violated Section 15(a). A separate cause of action against

Peraza arose each time it served as a cause of Angel Oak's Section 15(a) violations, and for each claim within the limitations period, the Division may pursue the monetary sanctions it seeks here.

Thus, although it is true that Angel Oak's illegal acts that Peraza helped cause in March 2010 could have been the basis for a complete cause of action against Peraza for which the Division could have sought relief, so were any violations in 2012, 2013, or 2014. In fact, the Division could not have obtained relief against Peraza for those latter violations until they accrued—i.e., until Angel Oak actually entered into, and Peraza facilitated, the trades. *Gabelli*, 568 U.S. at 448 ("[A] right accrues when it comes into existence." (quoting *United States v. Lindsay*, 346 U.S. 568, 569 (1954))); *see also Bay Area Laundry & Dry Cleaning Pension Trust Fund v. Ferbar Corp. of Cal.*, 522 U.S. 192, 201 (1997) ("Unless Congress has told us otherwise in the legislation at issue, a cause of action does not become 'complete and present' for limitations purposes *until* the plaintiff can file suit and obtain relief." (emphasis added)).

This view is supported by the Seventh Circuit's ruling in *Birkelbach*, which denied a petition for review from the Commission's decision in *William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752 (July 2, 2013). In *Birkelbach*, the court rejected a claim that the appellant's failure to supervise under FINRA rules "was a single indivisible act which accrued on the day of the first failure to supervise" and held instead that it was "an ongoing series of violations" and was "divisible such that [the Commission] could consider the timely violative conduct, even if there was additional untimely violative conduct" outside of § 2462's window. 751 F.3d at 479. Where there are a series of violations, "any violative conduct that falls within the statute of limitations is independently sanctionable, regardless of whether there was additional violative conduct which occurred before that time." *Id.*; *see also William J. Murphy*, 2013 WL 3327752, at *23 (explaining that "conduct by Applicants sufficient to sustain each of the violations under review continued until well after July 30, 2003—the date five years before FINRA issued its complaint"). The Commission has reached the same conclusion in other cases as well. *See Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *18 (Dec. 11, 2009) (holding that § 2462 did not bar the sanctions imposed because some of the respondent's transactions that were part of the kickback scheme took place within the limitations period), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010).[3]

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[3] Insofar as *Riordan* did not apply § 2462 to disgorgement, that aspect of the decision has been abrogated by *Kokesh*.

Peraza relies on the Tenth Circuit's decision in *Sierra Club v. Oklahoma Gas & Electric Co.*, 816 F.3d 666 (10th Cir. 2016), in which the court held that civil penalties for the modification of a boiler without the appropriate Clean Air Act permit were time-barred because the "violation first accrued when modification commenced," which was more than five years before the suit. *Id.* at 672. The court explained that "constructing or modifying a facility is best characterized as a single, ongoing act" for which suit could have been brought "on the first day of modification." *Id.* at 672-73. And indeed, the modification of a boiler is a single project of defined scope—and it took only one month. *Id.* at 670. Here, on the other hand, Angel Oak entered into separate transactions with multiple customers as an unregistered broker-dealer for years, and Peraza facilitated Angel Oak's activity throughout that period. *See* OIP at 2, 6, 8. Thus, it cannot be reasonably said that Angel Oak's and Peraza's activities were one project with one accrual date.

Peraza also argues that the "separate accrual doctrine" allowing multiple claims for multiple violations does not apply to § 2462, because the statute requires claims to be brought when they "*first* accrue[]," while other statutes of limitations omit the word "first." Surreply at 6-8. But this argument is also contrary to *Birkelbach* and the Commission's rulings: the fact that violations began outside the limitations period does not preclude sanctions for violations that occurred within the limitations period. *Birkelbach*, 751 F.3d at 479; *William J. Murphy*, 2013 WL 3327752, at *23; *Guy P. Riordan*, 2009 WL 4731397, at *18. Separate accrual simply means that "when a defendant commits successive violations, the statute of limitations runs separately from each violation." *Petrella v. Metro-Goldwyn-Mayer, Inc.*, 134 S. Ct. 1962, 1969 (2014). One simply cannot say that this principle is categorically inapplicable to violations subject to § 2462. Indeed, even *Sierra Club* acknowledged as much:

> The distinction between a single, continuing violation and repeated, discrete violations is important because an entirely new violation would first accrue apart from the other violations in the series and would begin a new statutory clock. In contrast, a single, continuing violation would not extend the limitations period of § 2462 because the statute would begin to run as soon as that violation *first* accrued and would not reset thereafter.

816 F.3d at 671 n.5 (citations omitted). The boiler modification fell into the latter category because it involved "merely the abatable but unabated inertial consequences of some pre-limitations action." *Id.* at 672 (quoting *Poster Exch., Inc. v. Nat'l Screen Serv. Corp.*, 517 F.2d 117, 128 (5th Cir. 1975)). In

contrast, this proceeding "involve[s] some affirmative conduct within the limitations period." *Id.* Although not every securities law violation will give rise to separate, successive violations, the ones here do, for the reasons explained above.

Peraza further argues that all of its actions facilitating Angel Oak's violations were completed by March 2010, and therefore it was not the cause of the violations within the limitations period. *See* Opp'n at 11; Surreply at 9 n.6. Peraza maintains, for example, that its arrangement to indirectly pay Angel Oak was "a single act," and that its "effect"—the continuing receipt of compensation from Angel Oak's violations—is unimportant to determining accrual. Surreply at 9 n.6. But Peraza's argument is incorrect. As discussed in greater detail below, Peraza was found to have caused Angel Oak's violations because it provided ongoing services facilitating Angel Oak's trading from 2010 to 2014; it also received commissions from the trading on an ongoing basis. *See* OIP at 8. For instance, Angel Oak needed Peraza's trading platform every time it entered into a trade. *See id.* And it was Peraza that sent the proceeds of the trades to Wells, who then sent a portion to Angel Oak. *Id.* Peraza was not found liable simply because it signed an agreement with Angel Oak in 2009 or because it first arranged to pay Angel Oak in 2010.[4] Therefore, just as Angel Oak's primary violations accrued within and throughout the limitations period, Peraza's causing violations did as well.

And finally, Peraza argues that the continuing violation doctrine does not apply here. *See* Opp'n at 9-14; Surreply at 8-9. The continuing violation doctrine "would permit the SEC to consider untimely violative conduct so long as there was some timely violative conduct and the conduct as a whole can be considered as a single course of conduct." *Birkelbach*, 751 F.3d at 749 n.7. But, whether or not the continuing violation doctrine could theoretically apply, it is irrelevant here because the Division expressly relinquished any claim for disgorgement that accrued outside the limitations period in 2010 and 2011. Reply at 4.

Disgorgement

Exchange Act Sections 21B(e) and 21C(e) authorize disgorgement, including reasonable interest, in this proceeding if appropriate. 15 U.S.C. §§ 78u-2(e), 78u-3(e); OIP at 9. "The paramount purpose of . . . ordering disgorgement is to make sure that wrongdoers will not profit from their

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[4] In fact, there is no evidence or suggestion in the OIP that Peraza and Angel Oak's agreement was illegal in and of itself.

wrongdoing." *Montford & Co.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *22 (May 2, 2014) (quoting *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987)), *pet. denied*, 793 F.3d 76 (D.C. Cir. 2015). That is, disgorgement "is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." *Id.* (quoting *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989)).

The standard for disgorgement is but-for causation. *Comeaux*, 2014 WL 4160054, at *3. Disgorgement "need only be a reasonable approximation of profits causally connected to the violation" because "separating legal from illegal profits exactly may at times be a near-impossible task." *First City*, 890 F.2d at 1231. The Division bears the initial burden of demonstrating such reasonable approximation. *Montford & Co.*, 2014 WL 1744130, at *22; *Comeaux*, 2014 WL 4160054, at *3. Once the Division does this, "[t]he burden then 'shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation.'" *Comeaux*, 2014 WL 4160054, at *3 (quoting *Gregory O. Trautman*, Securities Act Release No. 9088A, 2009 WL 6761741, at *22 (Dec. 15, 2009)).

The Division initially requested Peraza disgorge the entire $1,521,705.87 it earned in commissions from 2010 through 2014. Motion at 6. After the Supreme Court's decision in *Kokesh*, the Division revised its request down to $1,180,487.98, which covers the period from 2012 through 2014 only. Reply at 4. The Division also asks for prejudgment interest on the disgorgement. Motion at 8-9; Reply at 4-5.

Peraza concedes that the Division's numbers accurately represent Peraza's commissions received from trading at the Atlanta office. Tr. 38-39; Opp'n at 3. However, in addition to its statute of limitations arguments, Peraza maintains that disgorgement is unwarranted for two reasons. First, Peraza argues that the money it received from Angel Oak's trading is not causally linked to its violations. Opp'n at 14-16. Second, Peraza claims it is entitled to offsets from disgorgement for expenses it incurred. *Id.* at 16-20. As discussed below, there are legal deficiencies in both of Peraza's arguments, but they present questions that require further evidence or briefing to resolve.

1. The Division has shown causation to some degree but a reasonable dispute remains that may affect total disgorgement.

Peraza argues that the Division has not proven a causal link between its actions and the disgorgement requested. Peraza notes that the Division "generally must distinguish between legally and illegally obtained profits," Opp'n at 14 (quoting *First City*, 890 F.2d at 1231), and maintains that its

profits were legally obtained because it merely received commissions for lawful securities transactions conducted by registered representatives of Peraza. *Id.* at 15-16. Peraza asserts that although Angel Oak's use of its own name was illegal because it was unregistered, that illegal conduct was remote from the money Peraza received through the lawful transactions on Peraza's own trading platform. *See* Surreply at 14-17.

Peraza's argument, however, ignores the fact it "received commissions as a result of [its] arrangement" with Angel Oak—an arrangement in which Peraza, by providing various services to Angel Oak, "facilitated" Angel Oak's "ability to operate as an unregistered broker-dealer." OIP at 6, 8. Among the services cited, the OIP references that Peraza provided access to its trading platform, clearing firm arrangement, and trade support services; it also "allowed" Angel Oak employees "to register with Peraza as licensed securities representatives." *Id.* at 8. Further, Peraza was the first to receive profits generated by Angel Oak's trading activities and, after retaining its share of commissions, paid out the remaining balance to an account for subsequent distribution to Angel Oak. *Id.* at 5-6. The fact that trades were processed in a legal manner does not eliminate Peraza's liability. Given that Peraza facilitated Angel Oak's violations and received commissions as a result of the arrangement, it cannot be said that Angel Oak's illegal conduct was remote from Peraza's receipt of commissions. There is some causal connection.

Nonetheless, the extent of that connection appears subject to dispute. The OIP states that Angel Oak employees, who were registered representatives of Peraza, "*often* used the 'Angel Oak' name" when marketing Angel Oak's securities business and soliciting customers, and that "trade confirmations provided to customers *routinely* indicated that it was 'Angel Oak' that was involved in the transaction." OIP at 2, 6 (emphasis added). This implies that Angel Oak employees might have *sometimes* marketed and traded in securities in their capacity as representatives of Peraza, without mention of Angel Oak. But even if the Angel Oak name was not always used, it arguably operated as an unregistered broker-dealer for all trades in which it received transaction-based compensation, which is "one of the hallmarks of being a broker-dealer." *Tagliaferri*, 2017 WL 632134, at *4. It thus might be reasonable to infer that Angel Oak acted as an unregistered broker for all trades during the March 2010 to October 2014 period made via the Atlanta office and Peraza's commissions received as a result of facilitating those trades were illicit gains, *see* OIP at 2, 5-6, but I cannot fully resolve this point on summary disposition.

I therefore direct the parties to further address and present additional evidence, if they so choose, on the connection between Angel Oak's illegal broker activities and the trades that resulted in Peraza's receipt of

commissions. The parties should specifically address whether any known trades that took place in the Atlanta office were not connected to Angel Oak's illegal broker activities.

2. Peraza has not yet demonstrated entitlement to disgorgement offsets.

Peraza does not dispute that the Division's disgorgement figure accurately represents the commissions it received from the trading at the Atlanta office. Tr. 38-39; Opp'n at 3. However, it claims that the amount must be offset by its legitimate business expenses. Opp'n at 16-20; Tr. 43. Although "the overwhelming weight of authority hold[s] that securities law violators may not offset their disgorgement liability with business expenses," *SEC v. Brown*, 658 F.3d 858, 861 (8th Cir. 2011) (alteration in original), it is unclear whether the Division should prevail on this issue as a matter of law on summary disposition, for two principal reasons.

First, although "SEC disgorgement sometimes is ordered without consideration of a defendant's expenses that reduced the amount of illegal profit," *Kokesh*, 137 S. Ct. at 1645, "the defendant is entitled to a deduction for all marginal costs incurred in producing the revenues that are subject to disgorgement," i.e., liability should be limited to net gains. *Id.* at 1644-45 (quoting, in parenthetical, Restatement (Third) of Restitution and Unjust Enrichment § 51, Cmt. h). If, however, Peraza's expenses were not direct transaction costs that reduced its net gains, the general rule is that an offset is unjustified, because "how a defendant chooses to spend his ill-gotten gains, whether it be for business expenses, personal use, or otherwise is immaterial to disgorgement." *Edgar R. Page*, Advisers Act Release No. 4400, 2016 WL 3030845, at *12 n.68 (May 27, 2016) (quoting *SEC v. Aerokinetic Energy Corp.*, 444 F. App'x 382, 385 (11th Cir. 2011)).

Admittedly, there are several facts here that do not support Peraza's entitlement to any offsets. There is evidence that clearinghouse costs for the trades were paid by Angel Oak, not Peraza. *See* Worland Reply Decl. Ex. E at 53-54 (deposition of David Wells). Moreover, the OIP indicates that Angel Oak, not Peraza, provided office space and equipment. OIP at 5. Still, it is not clear at this stage what expenses are at issue. At oral argument, for example, Peraza's counsel indicated that Peraza's relevant costs pertain to the operation of the Atlanta branch office, but provided no specifics. *See* Tr. 43. While that could be reason alone for finding against Peraza, *see Page*, 2016 WL 3030845, at *12 n.68 (failure by respondent to identify expenses to be offset constitutes a failure to meet burden to show that the disgorgement calculation is unreasonable), the more prudent course would be to develop a better record and then decide the issue.

Second, Peraza argues that it warrants an exception to the general rule disallowing deductions for expenses because, among other reasons, this case does not arise in the context of fraud. *Cf.* Restatement (Third) of Restitution and Unjust Enrichment § 51, Cmt. h ("Cases that address issues of deductions and credits are concerned, almost exclusively, with the liability of conscious wrongdoers to disgorge profits."). Although Peraza has not presented any compelling reason to distinguish between fraud and other violations—and disgorgement applies to both—I will not decide this issue on summary disposition.

Thus, I will allow Peraza to present evidence on this issue if it chooses and will allow the parties to further address whether and what offsets are appropriate.[5]

3. Other considerations.

At stake in this proceeding is potential disgorgement of over $1 million, plus prejudgment interest, for causing a Section 15(a) violation. Disgorgement and prejudgment interest are discretionary, equitable remedies. *See* 15 U.S.C. §§ 78u-2(e) ("the Commission . . . *may* enter an order requiring accounting and disgorgement" (emphasis added)), 78u-3(e) (same); *SEC v. Sargent*, 329 F.3d 34, 40 (1st Cir. 2003); *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 95 & 103 n.13 (2d Cir. 1978). However, at least one Commission decision suggests that in determining disgorgement, discretion is limited. *Comeaux*, 2014 WL 4160054, at *3, *5. In *Comeaux,* the Commission "reject[ed] [the] contention that, in determining disgorgement, [it] should apply the public interest factors set forth in *Steadman v. SEC*" and the securities statutes. *Id.* at *5. But *Comeaux* was a remand order, not a final agency action. Moreover, *Comeaux* relied in part on the notion that disgorgement, unlike a bar or civil penalty, is not a "punitive sanction," *id.*, which has been cast into doubt by *Kokesh*. 137 S. Ct. at 1643-44.

Therefore, I direct the parties to address whether the above statement from *Comeaux* is binding precedent and whether any other considerations, beyond those articulated in *Comeaux*, should guide the decision whether to impose disgorgement and prejudgment interest in a Commission proceeding,

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[5] Among other matters, the parties could address whether any taxes Peraza paid on its commissions may be offset from disgorgement in light of *Kokesh*'s ruling that disgorgement is a penalty. *See Kokesh*, 137 S. Ct. at 1643-44; *Curtis A. Peterson*, Initial Decision Release No. 1124, 2017 WL 1397544, at *5-7 (ALJ Apr. 19, 2017).

particularly in this proceeding, which concerns not a direct violation or fraud, but rather causing a Section 15(a) violation.

Civil Penalties

Exchange Act Section 21B authorizes civil penalties in a cease-and-desist proceeding where a respondent is the cause of a violation of any provision of the Exchange Act. 15 U.S.C. § 78u-2(a)(2)(B). In the three-tier system for imposing civil penalties, first-tier penalties are authorized for each act or omission. 15 U.S.C. § 78u-2(b)(1). Second-tier and third-tier penalties require consideration of a respondent's state of mind and any losses caused or pecuniary gain achieved. *See* 15 U.S.C. § 78u-2(b)(2)-(3). The maximum first-tier civil penalty for an entity's violation from March 4, 2009, to March 5, 2013, is $75,000, and $80,000 for violations from March 6, 2013, to November 2, 2015. 17 C.F.R. § 201.1001 tbl. I.

The Division requests a $75,000 first-tier civil penalty. Motion at 9-10. The Division argues that although Peraza did not act willfully, its behavior was "a very serious infraction" as it "turned its back on what was going on in Atlanta, while achieving a substantial pecuniary gain from its behavior over a period that lasted more than four years." *Id.* Peraza maintains that the requested penalty is inappropriate because the Division clearly did not consider its infraction so egregious; it waited several years after it was aware of Angel Oak's and Peraza's conduct before bringing an enforcement action. Opp'n at 20-21.

I will not decide the matter of civil penalties on motion, at least not without additional argument or evidence pertaining to whether a penalty is in the public interest.[6] Tr. 48-50; *see* 15 U.S.C. § 78u-2(c); *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) ("[T]he SEC must provide some meaningful explanation for imposing sanctions."). Thus far, the parties have not provided much argument or evidence about the seriousness of Peraza's violations. Additional evidence could be documentary or testimonial. If they so choose, the parties may stipulate to the relevance or irrelevance of certain public interest factors.

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[6] Although Section 21B(a)(2) does not explicitly reference a public interest requirement, the Commission's authority to impose a civil penalty under that section is discretionary. It would be incongruent if the Commission's discretion under Section 21B(a)(2) was not guided by the same public interest factors that normally inform its decision-making process when imposing monetary sanctions.

Order

The Division's motion for summary disposition is GRANTED IN PART. The disgorgement and civil penalties sought by the Division are not barred by 28 U.S.C. § 2462's statute of limitations, and Peraza's receipt of commissions was, at least to some degree, causally connected to the violations for disgorgement purposes. I otherwise DENY the motion.

By March 16, 2018, the parties shall file a joint motion indicating how they wish to proceed. If they wish to present evidence at a hearing regarding the aspects of causation, offsets, and civil penalties I identify above, they should propose a date for a hearing within the next three months and a schedule for prehearing submissions. I would not expect that any prehearing submissions aside from witness and exhibit lists would be necessary.

If Peraza instead wishes to waive its right to a hearing, the parties should propose a schedule for the submission of additional briefing or evidence on the matters identified above.

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Jason S. Patil
Administrative Law Judge