

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 72179 / May 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3836 / May 16, 2014

INVESTMENT COMPANY ACT OF 1940
Rel. No. 31047 / May 16, 2014

Admin. Proc. File No. 3-14355

In the Matter of

DONALD L. KOCH and KOCH ASSET
MANAGEMENT, LLC
c/o Thomas O. Gorman
Dorsey & Whitney LLP
1801 K Street, NW, Suite 750
Washington, DC 20006

OPINION OF THE COMMISSION

EXCHANGE ACT PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY ACT PROCEEDING

Grounds for Remedial Action

Manipulation

Failure to Implement Policies and Procedures

Investment adviser and its owner and principal engaged in fraudulent and manipulative conduct by "marking the close" in the purchase of securities. *Held*, it is in the public interest to impose a cease-and-desist order on respondents, order disgorgement of \$4,169.78, plus prejudgment interest, assess a \$75,000 civil penalty, censure investment adviser, and impose a collateral bar on principal.

APPEARANCES:

Thomas O. Gorman and Cecilie H. MacIntyre, of Dorsey & Whitney LLP, for Donald L. Koch and Koch Asset Management, LLC.

Suzanne J. Romajas and Adam S. Aderton, for the Division of Enforcement.

Appeal filed: July 6, 2012

Last brief received: October 31, 2012

I.

Koch Asset Management LLC ("KAM") and Donald L. Koch, KAM's founder, sole owner, and principal, appeal from an initial decision of an administrative law judge.¹ The law judge found that Respondents violated antifraud provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 by "marking the close," a form of market manipulation, in the purchase of securities for advisory clients. The law judge also found that Respondents violated Advisers Act Rule 206(4)-7 by failing to implement written policies and procedures designed to prevent violations of the Advisers Act and rules promulgated thereunder. The law judge ordered Respondents to cease and desist from further violations; disgorge \$4,169.78 in ill-gotten gains, plus prejudgment interest; and pay a second-tier civil penalty of \$75,000.² The law judge also censured KAM and barred Koch from association with an investment adviser. Our findings are based on an independent review of the record except for findings that are not challenged on appeal.

II.**A. Respondents' background**

Before founding KAM in 1992, Koch had considerable experience in the banking industry. In the 1970s, he was a senior officer of a regional bank and was involved with the bank's acquisitions of many smaller banks. Koch then served as chief economist with the Federal Reserve Bank of Atlanta and thereafter as a professor of finance and banking at the Georgia Institute of Technology. After this, Koch moved to St. Louis, Missouri, and worked as a consultant to banks on regulatory and compliance issues and assisted the Resolution Trust Corporation in the resolution of financial institutions affected by the savings-and-loan crisis. In the late 1980s, Koch began investing his own money in small bank stocks based on the knowledge and insights he had gained in the industry. After experiencing some initial success through his own investing, Koch founded KAM and began managing the investments of close friends and associates.

¹ *Donald L. Koch*, Initial Decision Release No. 458, 2012 SEC LEXIS 1645 (May 24, 2012).

² The law judge imposed the disgorgement and civil penalty jointly and severally upon Respondents.

KAM's investment strategy was to buy the stock of small community banks as long-term investments. Based on his experience, Koch believed that the shares of many small banks were undervalued. Koch researched small banks and calculated what he termed the "tangible book value" of the bank. KAM sought to purchase stock of promising banks at or below the tangible book value per share. It was Koch's experience that if a small bank was acquired by a larger bank, the larger bank would pay two or more times tangible book value. In the event of such a sale, shares bought at or below tangible book value would yield a considerable return. Given the consolidation occurring in the banking industry, Koch expected many of the undervalued banks he invested in to be purchased, and in the meantime, some of the banks paid regular dividends.

KAM's first clients were Koch's neighbors and long-time friends who had approached him about helping them invest. KAM did not advertise and did not have a website, but KAM's client list grew over time through word of mouth and personal connections, with most clients being individuals and families Koch had known for a long time. Before accepting a new client, Koch made sure that the potential client understood KAM's investment approach and in particular understood that the investment was for the long-term. Koch was not interested in clients who wanted to use their accounts "as a checking account" or were inclined to "watch the paint dry"—instead he only wanted clients who accepted a long time horizon for their investments and were willing to let Koch pursue KAM's investment approach unhindered.³ Koch was particularly concerned about investment performance because many of KAM's clients were his friends or people he would interact with regularly. Koch testified that when you know your clients well "the last thing you need is to take money from someone and not perform."⁴ Although he had an assistant who helped with clerical duties, Koch was the only employee of KAM involved in advising investors.

KAM charged its clients a quarterly fee of 0.25% of the account's value, which was not charged if the account's value declined. Between 1996 and 2010, KAM waived over \$234,000 in quarterly client fees. KAM also charged a yearly fee of 20% of realized net gains that exceeded 5% per year. KAM ultimately had about forty fee-paying advisory accounts held by members of about thirty families. KAM also maintained accounts for Koch and members of his family as well as for Koch's assistant, Fay Heidtbrink; these accounts were not charged fees.

KAM used Huntleigh Securities Corporation, a registered broker-dealer in St. Louis, to execute trades and serve as a custodial institution for client accounts. After Huntleigh began offering account holders online access to their accounts, Koch told his registered representative, Catherine Marshall, who was also Huntleigh's compliance officer, that he wanted KAM's clients to get information about their accounts from him.⁵ On August 26, 2009, Koch sent an e-mail to Marshall requesting the names of his clients who had online access to their accounts and who checked their accounts regularly so he could "be prepared to anticipate who is going to call" and

³ Hearing Transcript ("Tr.") at 796.

⁴ Tr. at 795.

⁵ See Tr. at 48.

to "anticipate their questions."⁶ After learning that he could find out which KAM accounts were enabled for online access (most were) but that Huntleigh could not currently determine how often any particular client accessed his or her account, Koch told Marshall that allowing clients to have online access "really only causes confusion."⁷ He explained that in the wake of the market downturn in the first half of 2009, "[s]ome of [KAM's] newer and younger clients, especially the women" had become too concerned with the short term performance of their KAM accounts and "want[ed] to watch the paint dry."⁸

When Koch wanted a trade executed on behalf of KAM, he would contact Huntleigh's trading desk directly rather than going through Marshall, his registered representative. In September 2009, the trader who had been Koch's contact at Huntleigh's trading desk left the firm and Huntleigh assigned another trader, Jeffrey Christanell, to execute trades for KAM.

B. Respondents engaged in end-of-day, end-of-month trading in three securities.

The allegations in this appeal concern trading on two days—September 30, 2009, and December 31, 2009—in three bank stocks—High Country Bancorp, Inc., Cheviot Financial Institution, and Carver Bancorp, Inc.⁹ Each is a small community bank with thinly traded and illiquid stock. Before the trading involved in the case, KAM had been investing in each for ten or more years.¹⁰

1. KAM purchased High Country shares at the end of the trading day on September 30, 2009.

At the end of September 2009, according to Christanell's testimony at the hearing, Koch instructed Christanell to buy shares of High Country in order to get a higher closing price for the stock.¹¹ This testimony is corroborated by a series of e-mail exchanges between Christanell and Koch on September 30, 2009. Christanell sent an e-mail to Koch shortly after 1:00 p.m., Central time, informing him that he had purchased 580 shares of High Country at an average price of

⁶ Div. Ex. 96. In a follow-up e-mail to Marshall, Koch explained that he "hate[d] to get blind sided when a client calls and tells [him] what the value of their account is from their on line access to Huntleigh." Div. Ex. 100.

⁷ Div. Ex. 121.

⁸ *Id.*

⁹ The Order Instituting Proceedings also alleged violations related to trading High Country stock on October 31, 2009, and November 30, 2009, but the law judge did not find violations for Respondents' trading on those days and the Division did not file a cross-petition for review. Accordingly, our review is limited to the violations that the law judge found and that are challenged by Respondents on appeal. *See* 17 C.F.R. § 201.411(d).

¹⁰ By the time Koch purchased Carver shares on December 31, 2009, he "was worried" about and had lost some confidence in the stock. Tr. at 905. In 2010, because the bank held too many non-performing loans, KAM sold its Carver shares. *Id.* at 850, 852-53.

¹¹ *See* Tr. 459-77.

\$16.6897 and that the current bid-ask spread for the stock was \$11.71 to \$20.¹² In the last line of the e-mail, Christanell told Koch: "Let me know what to do from here."¹³

Koch then asked Christanell, with reference to High Country, how stocks are priced at the end of the day or month—whether the price is based on the last executed trade or the last bid.¹⁴ Christanell responded to Koch in an e-mail at 1:30 p.m.:

If a stock trades on a day, it's priced at the last trade. If it doesn't trade, say no trading volume for a couple of days, it gets priced on the bid.

In the case of [High Country] today, it will get priced on the last trade.¹⁵

Koch responded by email at 1:43 p.m.: "good. move last trade right before 3pm up to as near \$25 as possible without appearing manipulative."¹⁶ At 1:45 p.m., Christanell replied: "Will do."¹⁷

Christanell then took steps to implement Koch's instructions. Approximately four minutes before the market closed, Christanell placed three separate orders for 1,000 shares each of High Country stock with a limit of \$24.50.¹⁸ Each order received partial fulfillment—one for 480 shares at \$20, one for 400 shares at \$22, and one for 120 shares at \$23.99.¹⁹ With less than a minute before the close of the market, Christanell then placed another three orders for High Country stock, each for 400 shares with a limit of \$24.²⁰ At seventeen seconds before the market closed, one of those orders was filled at a price of \$23.50.²¹ This trade established the closing price of High Country on September 30, 2009.²² The 1,980 shares of High Country purchased by KAM on September 30, 2009, represented all of the trading volume reported that day.²³ All

¹² Div. Ex. 144. All times in this opinion are expressed in Central time, the time zone in which Huntleigh was located. E-mail exhibits in the record reflect a variety of different time zones, including GMT and Eastern. For example, Exhibit 144 bears the time "2:11:41 PM," but it is apparent from the e-mail's inclusion in e-mail chains in other exhibits, *see* Div. Exs. 148, 149, that this time refers to Eastern time, which would mean the e-mail was sent at 1:11 p.m., Central time.

¹³ *Id.*

¹⁴ Div. Ex. 145.

¹⁵ Div. Ex. 146.

¹⁶ Div. Ex. 148.

¹⁷ Div. Ex. 149.

¹⁸ Div. Ex. 278. We use the term "placed" here and throughout the opinion to mean when Christanell routed the order to the street—*i.e.*, when he electronically sent the order out from Huntleigh to receive executions in the market.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*; Div. Exs. 263, 277.

²³ Div. Ex. 263.

of the High Country shares purchased by KAM on September 30, 2009, were allocated to the account of Alice Smith, an elderly widow and one of KAM's oldest clients.

2. KAM purchased High Country, Cheviot, and Carver shares at the end of the trading day on December 31, 2009.

At the end of December 2009, according to Christanell's testimony, Koch again instructed him to try to set the closing price for High Country as well as for Cheviot and Carver.²⁴ On December 23, 2009, Koch sent an e-mail to Christanell that included the following: "I also want to move up [High Country] the last day of the year before things close downso, please be mindful of that if you are there or your backup is around....should be a busy day."²⁵ Then, on December 28, 2009, Koch sent Christanell the following e-mail:

²⁴ See Tr. 498-501.

Q: Do you also recall that in December 2009 Mr. Koch instructed you to get a closing price on HCBC [*i.e.*, High Country], right?

A: Yes.

...

Q: Do you recall any conversations that you had with Mr. Koch concerning these trades in HCBC on the last day of December?

A: I remember conversations we had that day, the last day of the year, the 31st, concerning HCBC and other stocks that he was active in.

Q: Okay. What other stocks do you recall discussing with him?

A: CHEV [*i.e.*, Cheviot]; Carver, CARV; and the HCBC.

Q: Any other stock you recall?

A: There may have been others but I don't recall.

Q: Okay. Well, what do you recall discussing with him about those stocks, aside from HCBC?

A: That he wanted to get the price up.

Q: Oh, so he wanted to get the price up on other stocks as well?

A: Or he wanted to get it to a certain—a certain level. I don't know if he used the term get the stock price up, but he wanted to get it to a certain price, particular price.

Q: Okay. And he wanted to get a closing price or he just wanted to increase the price; do you recall?

A: He wanted the closing price to be at a certain level.

²⁵ Resp. Ex. 33 (ellipses in original).

Dear Jeff,

Please put on your calendar to buy [High Country] 30 minutes to an hour before the close of market for the year. I would like to get a closing price in the 20-25 range, but certainly above 20. Thanks, DLK²⁶

Five minutes later, Christanell replied that he "[j]ust set an alert" and that he would "work on it on Thursday [December 31]."²⁷

On December 31, 2009, Christanell and Koch had several telephone conversations about Koch's requested end-of-year trading. These conversations were captured by a recording system at Huntleigh that recorded calls to and from the trading desk, primarily to resolve possible trade discrepancies.²⁸ Koch called Christanell in the morning to discuss his instructions for the purchase of High Country stock that day, saying that "my parameters are—if you need 5,000 shares, do whatever you have to do—I need to get it above 20, you know, 20 to 25, I'm happy."²⁹ Koch added with regard to the timing of the trades: "You figure out if you want to do it the last half hour—and just create prints."³⁰ Christanell testified that he understood Koch's instruction to create prints as a direction to "get the stock price up" for the last trade of the day.³¹ Christanell responded that he may "start in the last hour or so" because last time he thought he "waited too

²⁶ Div. Ex. 186.

²⁷ Div. Ex. 187.

²⁸ Tr. at 94; *see also* Div. Ex. 36 at 69. Respondents objected to the admission of these recordings (Division Exhibits 188 through 193) before the law judge and mention the issue of the recordings' admissibility and reliability in footnotes in their petition for review and briefs. *See* Pet. for Review at 6 n.5; Resp'ts Br. at 5 n.4; Resp'ts Reply Br. at 1 n.2, 16 n.11. We find no basis to overturn the law judge's admission of the audio recordings and conclude that we may properly rely upon them. There is no dispute concerning the authenticity of the recordings and there is no evidence of any alteration or manipulation. While the fact that Huntleigh had recordings only for December 31, 2009, is not fully explained in the record, we reject Respondents' suggestion that this by itself makes the recordings somehow unreliable. The recorded conversations are highly relevant evidence of Koch's state of mind at the time of the alleged violations. Similarly, we reject the suggestion made by Respondents before the law judge that the doctrine of completeness somehow limits the admissibility of these recordings. The doctrine of completeness allows the party against whom a statement or portion of a statement has been introduced in evidence to introduce additional portions of the statement or another statement when necessary to "eliminate the misleading impression created by taking a statement out of context." *United States v. Costner*, 684 F.2d 370, 373 (6th Cir. 1982). The recordings admitted by the law judge are six entire telephone conversations between Koch and Christanell. The law judge thus admitted complete statements, and the fact that Huntleigh's system did not retain other possible statements by Koch does not affect the admissibility or reliability of the admitted statements under the doctrine of completeness. Finally, Respondents are correct that the time of day assigned to the recordings by Huntleigh's system appears to be incorrect in at least one case: Exhibit 192 is a conversation that takes place after the close of the market, but it is time stamped ten minutes before the market closed. There is no dispute, however, that all of the telephone conversations captured in the recordings occurred on December 31, 2009, and the exact time at which the conversations took place on that day is largely irrelevant. Thus, the fact that there is a slightly incorrect time-stamp on at least one of the recordings does not render the recordings unreliable.

²⁹ Div. Ex. 189. The telephone conversations were admitted as audio files and there is no transcript of the recordings in the record. The quotations from the recordings in this opinion are based upon our own transcription.

³⁰ *Id.*

³¹ Tr. at 505.

long and then the guy just didn't move."³² Koch replied, "I don't want to tell you your job, but get it up there."³³ Koch then warned that "if you come in too early, there is a seller" and once the seller is aware of the trading "he'll push out the volume."³⁴ Before ending the conversation, Koch reiterated that he was willing to "go up to 5,000 shares if you need to," and he told Christanell to "talk if you need more than that."³⁵

Later in the morning, Koch called Christanell again. After confirming that the market closed at the regular time that day, Koch told Christanell that "we may give you some more orders here."³⁶ He said that his assistant, Fay Heidtbrink, was looking to "see what else we want to move up toward the end of the year," and he told Christanell to expect "some more orders on a couple of these thin stocks I want to push up a little bit."³⁷

Koch called the trading desk again around mid-day. After Christanell told Koch that the bid-ask spread for Cheviot was \$7.20 to \$7.48, Koch said, "Let's see if by the end of the day you move it to above 8—8, 8 and a quarter," to which he added, "that should be pretty easy."³⁸ Koch then turned his attention to Carver. After Christanell told him that the bid-ask spread for Carver was \$8.10 to \$9.05, Koch asked if there had been any trades that day and Christanell responded, "no trades, no volume."³⁹ Koch replied, "Okay, so what you do at the end of the day—pop that one—to 9.05, if you have to."⁴⁰ Christanell affirmed, "Yeah, to make a print."⁴¹

About an hour before the market closed, Koch made another call to the trading desk to ask Christanell how he was "coming along."⁴² Christanell said that he had not "done anything yet."⁴³ Koch then began to summarize his instructions: "So we got three [stocks]—we got Cheviot, and . . ."⁴⁴ At this point, Christanell interrupted to ask a question about Cheviot: "How much should I buy to get it up there?"⁴⁵ Koch responded, "I'd start at the 100, 200 share increment and see how far it moves," adding that "since it trades so little, I think you'll be able to

³² Div. Ex. 189.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ Div. Ex. 193.

³⁷ *Id.*

³⁸ Div. Ex. 191.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² Div. Ex. 190.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

get it up pretty fast."⁴⁶ Then, after a brief discussion of the existing offers for Cheviot in the market, Christanell asked, "Am I alright taking 5,000 [shares] if I have to?"⁴⁷ Koch replied, "absolutely," and added, "you know, on both of them," to which Christanell affirmed, "Yeah, with [High Country] also."⁴⁸ Christanell then turned the conversation to Carver: "I was thinking about just buying like 300 shares at 9.05. Is that alright?"⁴⁹

Koch: Sure. That's perfect. Just make sure you get a print.

Christanell: Yep, I was going to wait on that until the very end.⁵⁰

Before the market closed, Christanell attempted to carry out Koch's instructions. With regard to High Country, approximately five minutes before 3:00 p.m., Christanell placed an order for 3,000 shares with a limit of \$25.⁵¹ In the next three minutes, he received a variety of executions filling this order ranging from 200 to 900 shares with prices between \$16.80 and \$19.50.⁵² Around the same time, another buyer bought 300 shares of High Country at \$17.50.⁵³ With a little over a minute before the market closed, Christanell placed another order for 2,000 shares with a limit of \$25.⁵⁴ This order received a partial fulfillment of 200 shares at \$19.50 thirty-two seconds before the market closed and set the closing price for High Country that day.⁵⁵ The 3,200 High Country shares purchased by KAM on December 31, 2009, represented 88.9% of the trading volume reported that day.

Christanell also attempted to carry out Koch's instructions by buying Cheviot stock at the end of the trading day. At 2:40 p.m., Christanell placed an order for 2,000 shares of Cheviot with an \$8.25 limit.⁵⁶ This order was quickly filled in over fifteen separate executions with share quantities ranging from four to 533 shares.⁵⁷ Although Christanell had purchased some shares in the order for \$8.00, the final execution for the order was at \$7.50.⁵⁸ Starting at about two minutes before the close of the market, Christanell placed orders for 5,000 more Cheviot shares

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ Div. Ex. 278.

⁵² *Id.*

⁵³ Div. Ex. 277.

⁵⁴ Div. Ex. 278.

⁵⁵ *Id.*; Div. Exs. 263, 277.

⁵⁶ Div. Ex. 278.

⁵⁷ *Id.*

⁵⁸ *Id.*

with an \$8.25 limit.⁵⁹ Although Christanell received an execution at \$7.99 approximately seven seconds before the market closed, another market participant had the final trade before the close at a price of \$7.39.⁶⁰ Christanell received some executions just seconds after 3:00 p.m., for as high as \$8.19, but these did not set the closing price for the stock because they came after the official close of the market.⁶¹ KAM's purchase of Cheviot shares on December 31, 2009, represented approximately 70.7% of the reported volume that day.

With regard to Carver, at 2:58 p.m., Christanell placed an order for 200 shares with a limit of \$9.05.⁶² This order was filled in two executions—one for 100 shares at \$9.045 and another for 100 shares at \$9.05.⁶³ These 200 shares represented the total volume of trading in Carver stock that day, and Carver closed at \$9.05.⁶⁴

When the trading day was over, Christanell called Koch to report.⁶⁵ Christanell was apologetic that he was not able to get higher closing prices for High Country and Cheviot.⁶⁶ Speaking about High Country, Christanell said, "I'm sorry . . . I know you wanted it higher and I tried."⁶⁷ Concerning Cheviot, Christanell explained that he was "busy with that one too," but despite several executions at \$8.00, the closing price was not at the target Koch had requested.⁶⁸ Christanell told Koch that he "bought some right at the bell" at \$8.00 but that the executions had been too late to set the closing price.⁶⁹ Koch responded: "Okay, you did the best you can."⁷⁰ Christanell reported that "Carver closed about 9.05," to which Koch replied, "Good."⁷¹ All of the High Country, Cheviot, and Carver shares purchased by KAM on December 31, 2009, were allocated to the account of an institutional client, Tampsco, which was managed by a long-time friend and client of Koch's.

⁵⁹ *Id.*

⁶⁰ *Id.*; Div. Exs. 265, 276.

⁶¹ *See* Div. Ex. 278.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ Div. Exs. 264, 275.

⁶⁵ *See* Div. Ex. 192. The time-stamp on this recording from Huntleigh's trading desk put the time at 2:48 p.m., Central time, but because the conversation during the call includes a discussion that the market had closed about ten minutes prior to the call, it appears that the time-stamp was off by approximately twenty minutes.

⁶⁶ Christanell's e-mail to Koch reporting the total shares bought that day and the average prices also included an apology: "Sorry, but it was difficult with a lot going on for the end of the year." Div. Ex. 194.

⁶⁷ Div. Ex. 192.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

C. Huntleigh investigated KAM's trading and ended its relationship with KAM.

On January 20, 2010, an investigator for NYSE Arca sent a letter to Marshall regarding trading activity in Cheviot on December 31, 2009.⁷² Among other things, the letter sought a "detailed description of why the trader(s) entered the trades" and information on Huntleigh's policies and procedures to prevent "marking the close." Marshall showed the letter to Christanell and indicated that she would need his help in preparing a response.⁷³ According to Marshall, Christanell appeared "upset" after reading the letter.⁷⁴ Christanell then told Marshall that his trading for KAM in High Country stock raised similar issues—and, in fact, KAM's purchases of High Country stock involved price moves at the end of the day that "were even more flagrant" than those identified in the NYSE Arca letter.⁷⁵ Christanell showed Marshall the December 28, 2009 e-mail in which Koch told Christanell to "buy [High Country] 30 minutes to an hour before the close of market for the year" and Koch said he "would like to get a closing price in the 20-25 range, but certainly above 20."⁷⁶ Marshall then launched an internal review of KAM's end-of-month trading.⁷⁷

By letter dated January 20, 2010, Marshall requested information from Koch on the purpose of KAM's High Country trades on the last trading days of September, October, November, and December 2009 and asked Koch "why these transactions should not be considered 'marking the close.'"⁷⁸ Koch responded on February 5, 2010, disclaiming any intentional or unintentional effort to mark the close. Koch stated that the High Country purchases allocated to Alice Smith's account were made at her request and that the High Country purchases allocated to Tampsco were made to decrease "excess cash" in the account.⁷⁹ Koch emphasized his general practice of trying to buy stock if it becomes available at a price below the tangible book value per share.⁸⁰ Based upon its inquiry, Huntleigh terminated Christanell's

⁷² Div. Ex. 33. The letter also asked about trading activity in Cheviot on January 4 and 6, 2010.

⁷³ Tr. at 81.

⁷⁴ *Id.*

⁷⁵ Tr. at 525; *see also* Tr. at 81-82.

⁷⁶ Tr. at 81-83; Div. Ex. 187.

⁷⁷ Tr. at 84-85, 116.

⁷⁸ Div. Ex. 22.

⁷⁹ Div. Ex. 24. On February 1, 2010, before responding to Marshall, Koch sent a draft of his response to Christanell, with the request "please do NOT forward." Div. Ex. 221. The draft response is substantially similar to the final response he sent to Marshall, except the draft response did not mention the Tampsco account. *Compare* Div. Ex. 221 *with* Div. Ex. 24.

⁸⁰ *Id.* On February 5, 2010, Koch also sent two e-mails to Christanell. In the first, Koch tells Christanell that "[y]ou have done nothing WRONG, and do not let any one pressure you to admitting a mistake which you did NOT commit." Div. Ex. 26. Koch speculates that, by going after Christanell and KAM, Huntleigh is trying to divert attention away from other potential misdeeds. *Id.* In the second e-mail, Koch says that "[a]fter things settle down, I would be happy to consider some arrangement of a joint partnership where I provide the trading capital." Div. Ex. 27. Koch again tells Christanell that "you did NO wrong" and suggests that "Huntleigh is trying to cover up something." *Id.*

employment for violating its trading policies on marking the close and also terminated its relationship with KAM.

D. Procedural background

In the spring of 2010, the Commission's Division of Enforcement began its investigation into the matter.⁸¹ On April 25, 2011, the Commission instituted proceedings against Respondents pursuant to Exchange Act Section 21C, Advisers Act Sections 203(e), 203(f), and 203(k), and Investment Company Act Section 9(b).⁸² The Order Instituting Proceedings alleged that Respondents engaged in a scheme to mark the close of High Country stock on the last trading days of September, October, November, and December 2009 and of Cheviot and Carver stock on the last trading day of December 2009 in violation of Exchange Act Section 10(b), Rule 10b-5 thereunder, and Advisers Act Sections 206(1) and 206(2). The OIP further alleged that as a result of this conduct Respondents breached their fiduciary duty to seek best execution for their clients. The OIP also alleged that Respondents failed to maintain required books and records in violation of Advisers Act Section 204 and Rule 204-2(a)(7) thereunder. Finally, the OIP alleged that Respondents failed to implement policies and procedures reasonably designed to prevent violations of the Advisers Act in violation of Advisers Act Rule 206(4)-7.

A hearing before the law judge took place over six days in January 2012 and included testimony from Koch, Christanell, Marshall, and Heidtbrink. In addition to fact witnesses, Respondents put forward the testimony of two experts: John Schneider and Gregory Jarrell. Schneider, a partner at KPMG and an accounting expert, testified that KAM consistently followed the investment program agreed to by its clients and that the stock purchases at issue in this case were consistent with that investment program. Jarrell, a professor of business and economics at the University of Rochester, testified as an expert on market economics. He based his opinion on his own expertise and trading data for the stocks at issue in the case, but he did not review any of the communications between Koch and Christanell related to the trades.

Jarrell testified that stocks generally trade in a "U-shaped" pattern, *i.e.*, most trading activity occurs at the start and end of the trading day when market liquidity is the greatest. Given that KAM invested heavily in illiquid stocks, Jarrell posited that it made economic sense for KAM to purchase shares at the end of the trading day. Jarrell further testified that KAM's trading in Cheviot and Carver on December 31, 2009, had minimal impacts on the prices of these stocks and did not set their closing price.⁸³ Based on these conclusions, Jarrell testified that it was his opinion that Respondents' trading in Cheviot and Carver did not represent marking the close. With regard to High Country, Jarrell testified that KAM's trading affected the price of the

⁸¹ On May 4, 2010, Koch e-mailed Christanell and asked him to "have your attorney call my attorney." Div. Ex. 28. Koch added that "[w]e both have a strong self-interest in being on the same side of this issue and having the SEC wrap up any issue with you or me quickly." *Id.*

⁸² On April 25, 2011, Huntleigh and Christanell entered a settlement with the Commission relating to the events at issue here. *Huntleigh Sec. Corp.*, Securities Exchange Act Release No. 64336, 2011 SEC LEXIS 1439 (Apr. 25, 2011).

⁸³ As discussed more fully below, the weight of the evidence does not support Jarrell's conclusion that KAM's trading did not set the closing price for Carver.

stock because it was extremely illiquid. Although he could not rule out marking the close for KAM's trading of High Country stock, Jarrell opined that KAM's end-of-month, end-of-day High Country purchases were part of a legitimate attempt to acquire an extremely illiquid and therefore difficult-to-obtain stock.

In an initial decision dated May 24, 2012, the law judge found that Respondents violated the antifraud provisions of the Exchange Act and the Advisers Act through marking-the-close transactions in High Country stock on September 30, 2009, and December 31, 2009, and in Cheviot and Carver stock on December 31, 2009. The law judge also found that Respondents violated Adviser Act Rule 206(4)-7 by failing to implement KAM's anti-manipulation policy.⁸⁴ The law judge ordered Respondents to cease and desist from violations of Exchange Act Section 10(b), Rule 10b-5 thereunder, Advisers Act Sections 206(1), 206(2), and 206(4), and Rule 206(4)-7 thereunder, to disgorge \$4,169.78 plus prejudgment interest, and to pay a second-tier penalty of \$75,000. In addition, the law judge censured KAM and barred Koch from association with an investment adviser. Respondents appeal from the law judge's initial decision.

III.

A.

Exchange Act Section 10(b) makes it unlawful to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."⁸⁵ Rule 10b-5 thereunder makes it unlawful "for any person, directly or indirectly . . . [t]o employ any device, scheme, or artifice to defraud" or "[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."⁸⁶ Advisers Act Section 206 contains similar proscriptions specifically applicable to investment advisers. Advisers Act Section 206(1) makes it unlawful for any investment adviser "to employ any device, scheme, or artifice to defraud any client or prospective client,"⁸⁷ and Section 206(2) makes it unlawful for any investment adviser "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."⁸⁸

Manipulation of the market for a security violates Exchange Act Section 10(b) and Rule 10b-5,⁸⁹ and an investment adviser engaged in market manipulation also violates Advisers Act

⁸⁴ The law judge found that the Division did not prove marking the close violations for KAM's trading in High Country stock at the end of October and November 2009. The law judge also found that the Division did not prove Respondents violated Advisers Act Rule 204-2(a)(7) regarding the maintenance of books and records.

⁸⁵ 15 U.S.C. § 78j(b).

⁸⁶ 17 C.F.R. § 240.10b-5(a) & (c).

⁸⁷ 15 U.S.C. § 80b-6(1).

⁸⁸ 15 U.S.C. § 80b-6(2).

⁸⁹ *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *15 (Apr. 26, 2006).

Section 206.⁹⁰ Manipulation has been defined as the "intentional interference with the free forces of supply and demand."⁹¹ "Manipulation of the market for securities is at the core of conduct that the securities laws were designed to prevent."⁹² We have noted that "[d]etermining whether a person has engaged in a manipulative scheme depends on inferences from a variety of factual detail, patterns of behavior, and, among other things, trading data."⁹³

"Marking the close' is the practice of attempting to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market."⁹⁴ We have previously held that "the practice of placing orders at the end of the day to cause a stock to close higher constitutes a manipulative practice."⁹⁵ The purchase of a security at the end of the trading day with the purpose of raising its reported price manipulates the market for the security because it "convey[s] false information to the market as to the stock's price level and therefore as to the demand for the stock free of manipulative influences."⁹⁶ In order to prove a marking-the-close violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and Advisers Act Section 206(1), the Division must show that Respondents (i) engaged in conduct evidencing a scheme to mark the close—*i.e.*, trading at or near the close of the market so as to influence the price of a security—and (ii) acted with scienter, defined as "a mental state embracing intent to deceive, manipulate, or defraud."⁹⁷ To find a violation of Advisers Act Section 206(2) requires only a finding of negligence.⁹⁸

⁹⁰ *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 SEC LEXIS 3015, at *33 (Dec. 21, 2007), *petition denied*, 33 F. App'x 334 (D.C. Cir. 2008) (per curiam) ("Facts showing a violation of . . . [Exchange Act Section] 10(b) by an investment advisor will also support a showing of a Section 206 violation." (alteration in original) (quoting *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007))).

⁹¹ *Yoshikawa*, 2006 SEC LEXIS 948, at *16 (quoting *Pagel, Inc.*, Exchange Act Release No. 22280, 48 SEC 223, 1985 SEC LEXIS 988, at *7 (Aug. 1, 1985)).

⁹² *Kirlin Sec. Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *42 (Dec. 10, 2009).

⁹³ *Amr Elgindy*, Exchange Act Release No. 49389, 57 SEC 431, 2004 SEC LEXIS 555, at *13 (Mar. 10, 2004).

⁹⁴ *Thomas C. Kocherhans*, Exchange Act Release No. 36556, 52 SEC 528, 1995 SEC LEXIS 3308, at *6 (Dec. 6, 1995).

⁹⁵ *Id.* at *7.

⁹⁶ *Id.* at *7; *see also Richard D. Chema*, Exchange Act Release No. 40719, 53 SEC 1049, 1998 SEC LEXIS 2592, at *14 (Nov. 30, 1998) (Marking the close "artificially influence[s]" a stock's "price level at the end of the day" and thereby "intentionally distort[s] the stock's market price, conveying false information to investors and the market.").

⁹⁷ *See Kirlin*, 2009 SEC LEXIS 4168, at *44-46 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) and recognizing that manipulation in violation of Rule 10b-5 depends upon "whether the trading and surrounding circumstances suggest an effort to 'interfer[e] with the free forces of supply and demand'"); *Kocherhans*, 1995 SEC LEXIS 3308, at *6-8 (finding marking-the-close violation where registered representative (1) engaged in trading within the last fifteen minutes of the trading day that raised the price of the security and (2) acted with scienter); *Disraeli*, 2007 SEC LEXIS 3015, at *33 (a violation of Advisers Act Section 206(1) requires a finding of scienter).

We do not adopt the standard for market manipulation advanced by the court in *SEC v. Masri*, 523 F. Supp. 2d 361 (S.D.N.Y. 2007). *Masri's* holding that a marking-the-close violation requires proof "that *but for* the manipulative intent, the defendant would not have conducted the transaction," *id.* at 372, is inconsistent with our

(continued...)

1. Respondents' trading in High Country constituted marking-the-close violations.

We find that Respondents unlawfully manipulated the market for High Country stock through marking-the-close transactions on September 30, 2009, and December 31, 2009. Respondents' trading activity is consistent with a scheme to mark the close of High Country stock on those days. On September 30, 2009, KAM purchased 1,980 shares of High Country, the vast majority in the last four minutes of trading. KAM's purchases represented 100% of the trading volume in High Country that day⁹⁹ and set the closing price for the stock at \$23.50. The day before (September 29, 2009) High Country had closed at \$18 and for the remainder of 2009 the stock never traded above \$20.¹⁰⁰ We find, therefore, that KAM's last minute trading in High Country on September 30, 2009, had the effect of raising the price of the stock.¹⁰¹

On December 31, 2009, KAM purchased 3,200 shares of High Country, all within the last five minutes of trading. These purchases represented 88.9% of the trading volume in High Country that day and set the closing price of the stock at \$19.50. The highest price for a non-KAM transaction in High Country on December 31, 2009, was \$17.50, and for over a year, High Country would never trade as high as its closing price on December 31, 2009.¹⁰² We find that

(...continued)

precedent, *see Kirlin*, 2009 SEC LEXIS 4168, at *58 (rejecting applicants' reliance on *Masri's* "but for" test), and, to our knowledge, has not been adopted by any other court, *cf., e.g., In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 391-92 (S.D.N.Y. 2003) (rejecting a "sole intent" standard for manipulation in the context of open market transactions as having no basis in case law). The law judge appears to have applied a version of *Masri's* holding in finding marking-the-close violations here, concluding that Koch "would not have bought [High Country, Cheviot, and Carver] on September 30 and December 31 at the prices at which they were executed but for his purpose of manipulating their closing prices." *Koch*, 2012 SEC LEXIS 1645, at * 37-38. But the Initial Decision applied *Masri's* "but for" test in a limited way: it found manipulation when "Koch's manipulative intent altered the timing and prices of his trades." *Id.* at *38. The law judge thus appears to have incorporated into her decision criticism of *Masri* by the court in *SEC v. Kwak*, No. 3:04-cv-1331, 2008 U.S. Dist. LEXIS 10201 (D. Conn. Feb. 12, 2008). *See Koch*, 2012 SEC LEXIS 1645, at *30 (citing *Kwak*, 2008 U.S. Dist. LEXIS 10201, at *16 n.10). *Kwak* noted that *Masri's* "but for" test "may make some sense . . . under the theory that there is nothing deceptive about a transaction if the exact same transaction would have been entered into absent the manipulative intent" but "that theory loses its applicability if the prohibited intent alters the trade in any material respect (*e.g.*, by changing the time at which the trade would have otherwise been executed)." 2008 U.S. Dist. LEXIS 10201, at *15 n.10. Although we do not adopt the test applied by the law judge, we agree that the evidence in the record shows that Respondents' manipulative intent caused them to alter their trading in some material respect.

⁹⁸ *Disraeli*, 2007 SEC LEXIS 3015, at *33; *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

⁹⁹ Domination of the market for a security by a market participant is a recognized characteristic of manipulation and here further supports the proposition that Respondents' trading was consistent with a scheme to mark the close. *See Kirlin*, 2009 SEC LEXIS 4168, at *45; *Pagel, Inc.*, Exchange Act Release No. 22280, 48 SEC 223, 1985 SEC LEXIS 988, at *13.

¹⁰⁰ *See Div. Ex. 263*. High Country's closing price would not again go above \$20 until February 2012.

¹⁰¹ A finding that Respondents succeeded in raising the price of the stock is not required to prove a marking-the-close violation. *See infra* note 118 and accompanying text.

¹⁰² *See Div. Ex. 263*.

KAM's High Country purchases on December 31, 2009, had the effect of raising the stock's price.¹⁰³

The evidence in the record also shows that Respondents purchased High Country shares on September 30, 2009, and December 31, 2009, with the express purpose of setting a higher closing price and thus acted with scienter. On September 30, 2009, Koch learned that, pursuant to Huntleigh's pricing policy, the last trade would establish the closing price. Koch then sent an e-mail to Christanell telling him to "move last trade right before 3pm up to as near \$25 as possible without appearing manipulative."¹⁰⁴ We agree with the law judge¹⁰⁵ that Koch's attempt to explain this e-mail as an instruction to Christanell to avoid driving up the price of the stock by trading in "as small of an increment as you can" is "unconvincing."¹⁰⁶ As the Division points out, "Koch's instruction contains no information at all about the size of incremental purchases that Christanell should make."¹⁰⁷ Instead, the e-mail contains an instruction for Christanell to attempt to raise the price of the stock "right before" the close of the market. As such, it is compelling direct evidence of Respondents' intent to mark the close of High Country stock on September 30, 2009. Indeed, Koch's instruction to Christanell to avoid "appearing manipulative" is evidence that Respondents understood that they were engaging in manipulative trading.¹⁰⁸ In addition to this e-mail, Christanell testified convincingly that Koch instructed him on September 30, 2009, to "get the [High Country stock] price between 20 and 25 at the end of the day" and

¹⁰³ Even Respondents' expert, Jarrell, conceded that KAM's end-of-day purchases of High Country on these dates had the effect of raising the price of the stock. *See* Resp'ts Ex. 39 at 61 ("KAM's trading in HCBC's stock would have impacted the price.").

¹⁰⁴ Div. Ex. 148.

¹⁰⁵ *Koch*, 2012 SEC LEXIS 1645, at *15. The law judge's credibility determinations are "entitled to considerable weight and deference. We reject such determinations only where there is substantial evidence in the record for doing so." *Martin R. Kaiden*, Exchange Act Release No. 41629, 54 SEC 194, 1999 SEC LEXIS 1396, at *22-23 (July 20, 1999). Here, we find no basis to reject the law judge's appraisal of Koch's self-serving testimony. We also do not disturb the law judge's finding that Koch's explanation for why he was asking about Huntleigh's pricing policy—*i.e.*, that he was merely taking a survey of various custodians—was also "not altogether convincing." *Koch*, 2012 SEC LEXIS 1645, at *14 n.9.

¹⁰⁶ Tr. at 879. When asked what he meant by the e-mail, Koch gave the following explanation:

Well, you know, . . . I had not worked with this gentleman that long, . . . and I [knew] he was an institutional trader. He was hired, and most of his activities were large block transactions. The last thing in the world you want is to be the elephant in the room, is to go there and . . . say, I'm an institutional player, get 5,000 shares. If he gives that signal to the market, the bid/ask goes—and I'm guessing here—30, 35. You destroy the entire market. So I am asking him to be as invisible as you can, to be as low keyed as you can, to do this at as small of an increment as you can without jumping up and down in the room, showing who you are, showing that you're an institutional trader.

Id. Koch's explanation may provide insight on how he thought Christanell should trade so as not to appear manipulative—*i.e.*, attempt to move the stock price up through incrementally higher purchases—but it completely fails to address why he wanted to "move the last trade . . . up to as near \$25 as possible."

¹⁰⁷ Div. Br. at 17.

¹⁰⁸ *See, e.g., Phillip J. Milligan*, Exchange Act Release No. 61790, 2010 SEC LEXIS 1163, at *19 (Mar. 26, 2010) ("[A]ttempts to conceal misconduct indicate scienter.").

that he executed trades near the close of the market "to get the price up to where [Koch] asked [him] to get it."¹⁰⁹

The evidence of Respondents' intent to mark the close of High Country stock on December 31, 2009, is likewise compelling. Over a week before the end of the year, Koch told Christanell in an e-mail that he "want[ed] to move up [High Country] the last day of the year."¹¹⁰ In another e-mail on December 28, 2009, he told Christanell "to buy [High Country] 30 minutes to an hour before the close of market for the year," explaining that he "would like to get a closing price [for High Country] in the 20-25 range, but certainly above 20."¹¹¹ These e-mails offer strong support for Respondents' intent to mark the close of High Country stock on December 31, 2009. In particular, in the December 28, 2009 e-mail Koch states unambiguously the reason for his instruction to buy High Country near the close of the market on December 31—"to get a closing price in the 20-25 range, but certainly above 20."

The recorded telephone conversations between Koch and Christanell on December 31, 2009, bolster the already strong evidence of intent. In one conversation, Koch told Christanell that "my parameters [for High Country] are—if you need 5,000 shares, do whatever you have to do—I need to get it above 20, you know, 20 to 25, I'm happy."¹¹² Later in the conversation, Koch made clear that the goal of the end-of-day High Country trading was to "just create prints,"¹¹³ which Christanell testified meant to "get the stock price up" for the last trade of the day.¹¹⁴ In their conversation after the market closed, Christanell apologized that High Country's closing price was not in the range requested by Koch, saying "I know you wanted it higher and I tried."¹¹⁵ As Christanell explained in his hearing testimony, he understood that Respondents' purpose for trading High Country on December 31, 2009, was to try "to get a particular price," specifically to "get the price between 20 and 25."¹¹⁶ When Christanell was unable to achieve this goal, he "remember[ed] that [he] was nervous about it because [he] didn't get the price that [Koch] wanted to get."¹¹⁷ We find that the record establishes that Respondents acted with scienter when they marked the close of High Country stock on December 31, 2009.

¹⁰⁹ Tr. at 474, 477.

¹¹⁰ Resp. Ex. 33.

¹¹¹ Div. Ex. 186.

¹¹² Div. Ex. 189.

¹¹³ *Id.*

¹¹⁴ Tr. at 505.

¹¹⁵ Div. Ex. 192.

¹¹⁶ Tr. at 504, 506.

¹¹⁷ Tr. at 513.

2. Respondents' trading in Cheviot and Carver constituted marking-the-close violations.

The evidence also establishes marking-the-close violations by Respondents on December 31, 2009, with respect to Cheviot and Carver stock. With regard to Cheviot, the record shows that KAM, whose trades represented 70.7% of the reported volume for Cheviot on December 31, 2009, made multiple purchases of the stock in the last twenty minutes of trading. Specifically, Christanell placed orders for several thousand shares of Cheviot in the final three minutes of trading. KAM's last execution from these orders was a purchase of 200 shares at a price of \$7.99 just seven seconds before 3 p.m., Central time, but a later non-KAM trade for Cheviot set the closing price for the stock at \$7.39. At nine seconds after 3 p.m., Christanell placed another KAM order for additional Cheviot shares, which almost immediately resulted in three executions—two at \$8.00 and one at \$8.19. These final three trades, however, came after the official close of the market and therefore none of them set the closing price.

Respondents' trading activity is consistent with a scheme to mark the close. Although KAM's Cheviot purchases did not set the closing price for the stock that day, it was not for lack of trying. As we have held, "[s]uccess is not a prerequisite for a finding of manipulation."¹¹⁸ KAM purchased Cheviot stock near the close of the market for prices significantly higher than other market participants that day. And KAM's final order, placed within seconds of the close of the market, is consistent with an attempt to raise the stock's closing price, even if it proved unsuccessful because it came too late.

Other evidence shows that it was Respondents' goal to set a closing price above \$8.00 for Cheviot on December 31, 2009. Early that day, Koch told Christanell that his assistant was looking to "see what else we want to move up toward the end of the year," and that Christanell should expect "some more orders on a couple of these thin stocks [Koch] want[ed] to push up a little bit."¹¹⁹ On a call later in the day, after hearing from Christanell that the bid-ask spread for Cheviot was \$7.20 to \$7.48, Koch asked Christanell to "move it to above 8—8, 8 and a quarter" "by the end of the day."¹²⁰ Koch thought that getting a closing price above \$8.00 "should be pretty easy,"¹²¹ explaining that "since it trades so little, I think you'll be able to get it up pretty fast."¹²² On his call reporting the day's trading, Christanell apologized that he was unable to get the closing price that Koch had sought. Christanell told Koch that, although he had "bought some right at the bell" for \$8.00, the trade had been too late to set the closing price.¹²³ Koch expressed disappointment but told Christanell, "Okay, you did the best you can."¹²⁴ These

¹¹⁸ *Elgindy*, 2004 SEC LEXIS 555, at *15; see also *SEC v. Martino*, 255 F. Supp. 2d 268, 287 (S.D.N.Y. 2003) ("[A]n attempted manipulation is as actionable as a successful one.").

¹¹⁹ Div. Ex. 193.

¹²⁰ Div. Ex. 191.

¹²¹ Div. Ex. 191.

¹²² Div. Ex. 190.

¹²³ Div. Ex. 192.

¹²⁴ *Id.*

telephone conversations are persuasive direct evidence of Respondents' intent to mark the close of Cheviot stock on December 31, 2009.¹²⁵

Respondents' trading in Carver on December 31, 2009, also evidences a scheme to mark the close. With less than two minutes before the market closed, Christanell placed a KAM order for 200 shares of Carver stock, which was filled in two executions—the first for 100 shares at \$9.045 and the second for another 100 shares at \$9.05.¹²⁶ These executions, at the high end of the bid-ask spread, represented an uptick in the price of the stock. Respondents point to the testimony of their expert, Jarrell, who concluded that KAM's trading did not set the closing price for Carver on December 31, 2009.¹²⁷ But Jarrell's position is inconsistent with the weight of the evidence in the record. The evidence shows that the total reported trading volume for Carver on December 31, 2009 was 200 shares¹²⁸ and that KAM purchased 200 shares of Carver on that day before the market closed.¹²⁹ In addition, KAM's final purchase of Carver stock on December 31, 2009, at approximately one-and-a-half minutes before the market closed was at a price of \$9.05,¹³⁰ the same as the reported closing price for the stock.¹³¹ Accordingly, we find a preponderance of the evidence establishes that KAM's final Carver trade set the closing price for the stock.¹³² But even if KAM's final Carver purchase did not represent the final trade of the day, Respondents' end-of-day trading is still consistent with a scheme to mark the close. As

¹²⁵ In addition, Christanell's hearing testimony confirms that on December 31, 2009, Koch's "instructions were to get the last trade in the 8 to 8.25 range" for Cheviot. Tr. at 512

¹²⁶ Div. Ex. 278.

¹²⁷ See Resp'ts Br. at 25 (citing Resp'ts Ex. 39 (Jarrell's presentation)); Resp'ts Reply Br. at 19-20 (citing Tr. 1098-1102). Jarrell's testimony that KAM's final trade did not set the closing price may come from a misreading of the trading data. Jarrell apparently relied upon the New York Stock Exchange Trade and Quote ("TAQ") database in reaching his conclusion that a trade by someone other than KAM for 100 shares of Carver at \$9.05 at three seconds after 3 p.m., Central time, set the closing price on December 31, 2009. See Resp. Ex. 39 at 36. The underlying data from the TAQ database upon which Jarrell relied for his opinion is not in the record, but the Division argued before the law judge, pointing to evidence admitted after the hearing, that the line entry in the TAQ database relied upon by Jarrell was "informational only" and did not represent an actual trade in the market. See Div. Mot. to Admit Div. Ex. 340 at 3-5; Div. Ex. 340 at 21. Respondents disputed before the law judge the relevance and foundation of the 2008 TAQ manual for countering Jarrell's testimony. See Resp'ts Surreply at 1-4. The law judge did not resolve this factual dispute, and because the law judge also declined to admit the underlying data upon which Jarrell relied in reaching his conclusion, it is difficult for us to do so. Nevertheless, we believe that a preponderance of the evidence in the record supports the conclusion that KAM's trading set the closing price for Carver on December 31, 2009. Jarrell's understanding of the TAQ data—that an additional non-KAM trade for 100 shares set the closing price—contradicts the fact that the total reported volume for Carver on that day was 200 shares, the same amount purchased by KAM. Respondents offer no explanation for this conflict between Jarrell's testimony and other evidence in the record.

¹²⁸ Div. Ex. 264 (Bloomberg reports); Div. Ex. 275 (FINRA Audit Trail).

¹²⁹ Div. Ex. 278.

¹³⁰ *Id.*

¹³¹ Div. Ex. 264.

¹³² The law judge did not make an explicit finding in this regard.

previously noted, a marking-the-close violation is not predicated upon Respondents' succeeding in their attempted manipulation.¹³³

We find further that Respondents acted with scienter in their purchase of Carver stock in the final minutes of the trading day on December 31, 2009. Telephone conversations between Koch and Christanell show that Koch's purpose in purchasing Carver was to set a higher closing price for the stock. Upon learning that the bid-ask spread for Carver was \$8.10 to \$9.05 and that there had not yet been any trading activity that day in the stock, Koch told Christanell to "at the end of the day ... pop that one [*i.e.*, Carver]—to 9.05, if you have to."¹³⁴ Later that day, Christanell told Koch that he intended to carry out Koch's instructions by buying around 300 shares of Carver at \$9.05, to which Koch responded: "That's perfect. Just make sure you get a print."¹³⁵ Koch's direction to "pop that one" and his insistence on getting a print—*i.e.*, on executing the trade that will set the closing price for the stock—show that his goal in purchasing Carver stock was to mark the close.¹³⁶ And the record shows that this is exactly how Christanell understood Koch's direction. In a telephone conversation with Koch, Christanell affirmed that purpose of KAM's purchase of Carver was "to make a print,"¹³⁷ and Christanell testified during the hearing that Koch's reason for purchasing Carver stock on December 31, 2009, was that "he wanted it to close at [\$]9[.]05."¹³⁸

* * *

Based on the proceeding analysis, we find that Respondents willfully¹³⁹ violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, as well as Advisers Act Section 206(1),¹⁴⁰ through a scheme to mark the close of High Country, Cheviot, and Carver stock.

¹³³ *Supra* note 118.

¹³⁴ Div. Ex. 191.

¹³⁵ Div. Ex. 190.

¹³⁶ When asked during the hearing what he meant by "pop that one," Koch responded, "I don't recall having meaning to that. I mean, I don't know. Was that—I don't know." Tr. at 906.

¹³⁷ Div. Ex. 191

¹³⁸ Tr. at 511.

¹³⁹ Respondents argue that the law judge did not find that their violations were willful, contending that "there is no finding of willfulness other than the finding that Respondents intended to trade as they did." Resp'ts Br. at 13. As the Division rightly points out, however, such a finding is all that is required to show willfulness here. Div. Br. at 36 (citing *Wonsover v. SEC*, 205 F.3d 408, 413-15 (D.C. Cir. 2000) (interpreting Exchange Act Section 15(b), which directly mirrors the relevant provisions of Advisers Act Section 203)). "[I]t has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation" and does not mean that "the actor [must] also be aware that he is violating one of the Rules or Acts." *Wonsover*, 205 F.3d at 414 (alteration in original) (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)). Our finding of scienter, amply supported by evidence in the record, demonstrates that Respondents' violations were willful.

¹⁴⁰ These findings also support of a violation of Advisers Act Section 206(2), which unlike Section 206(1), requires only a showing of negligence. *Supra* note 98. Because we have found that Respondents acted with scienter, the lesser negligence standard of Section 206(2) is also satisfied. Respondents' suggestion that the law

(continued...)

B.

Respondents raise several challenges to the law judge's findings of marking-the-close violations. We find none of them convincing. Respondents argue that the law judge did not find that Respondents were engaged in deception, which they argue is essential to a finding of manipulation.¹⁴¹ Respondents are correct that deception must be part of any manipulative scheme,¹⁴² but they misconstrue the meaning of this requirement. The Division is not required to show that particular investors were misled by Respondents' conduct, but only that Respondents were "engaged in fraud or deceit as to the nature of the market for the security."¹⁴³ As shown above, Respondents entered the market with the intent of raising the price of the securities they were purchasing, which is directly contrary to the intent of a purchaser who is *not* trying to manipulate the market, namely, acquiring the securities at the best available price. By attempting to raise the price of the stocks they were purchasing, Respondents "intentionally interfered with the factors upon which market value depends"¹⁴⁴ and "distorted the stock[s] market price[s], conveying false information to investors and market participants."¹⁴⁵ Respondents conduct was deceptive because it "conveyed false information to the market as to the stock[s] price level[s] and therefore as to the demand for the stock[s] free of manipulative influence."¹⁴⁶ By engaging in transactions with the market-distorting intent of pushing up the

(...continued)

judge failed to make a finding that they violated Advisers Act Section 206(2), *see* Resp'ts Reply Br. at 6 n.7, is specious. *See Koch*, 2012 SEC LEXIS 1645, at *27, *35 ("The record shows that Respondents violated . . . Advisers Act Sections 206(1), 206(2) . . .").

¹⁴¹ Resp'ts Br. at 9-10, 15. Related to this argument, Respondents insist that the Initial Decision failed to properly articulate the standards upon which it found violations and this failure is inconsistent with *Rapoport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012). Respondents' reliance on *Rapoport* is misplaced. *Rapoport* remanded to the Commission a case in which the court held the Commission did not adequately articulate a rationale for departing from its own precedent involving the interpretation of a Commission rule of practice. *Rapoport* is inapplicable because any failure to articulate the proper standard by the law judge is cured by our *de novo* review. *See Gary M Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *35 n.44 (Feb. 13, 2009).

¹⁴² *See Ernst & Ernst*, 425 U.S. at 199 (Exchange Act Section 10(b)'s use of "manipulative" "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); *Wilson v. Merrill Lynch & Co.*, 671 F.3d 120, 130 (2d Cir. 2011) ("The gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators." (quoting *Gurary v. Winehouse*, 190 F.3d 37, 45 (2d Cir. 1999))).

¹⁴³ *Yoshikawa*, 2006 SEC LEXIS 948, at *16.

¹⁴⁴ *Kocherhans*, 1995 SEC LEXIS 3308, at *7.

¹⁴⁵ *Adrian C. Havill*, Exchange Act Release No. 40726, 53 SEC 1060, 1998 SEC LEXIS 2599, at *12 (Nov. 30, 1998).

¹⁴⁶ *Kocherhans*, 1995 SEC LEXIS 3308, at *7; *see also Swartwood, Hesse, Inc.*, Exchange Act Release No. 31212, 50 SEC 1301, 1992 SEC LEXIS 2412, at *18 (Sept. 22, 1992) ("Basically, the manipulated price of [the stock], which was perceived by investors as the best information on how others valued the security, deceived the marketplace since it was contrary to the value that would otherwise have been dictated by supply and demand."); *Pagel, Inc.*, 1985 SEC LEXIS 988, at *13 ("When individuals occupying a dominant market position engage in a scheme to distort the price of a security for their own benefit, they violate the securities laws by perpetuating a fraud on all public investors.").

price of the stocks that they were purchasing, Respondents deceived other market participants who were "entitled to assume that the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand so that those prices are the collective marketplace judgments that they purport to be."¹⁴⁷

Respondents argue that manipulation involves "actions such as wash sales and matched orders which are designed to deceive investors by feigning actual market activity,"¹⁴⁸ suggesting that manipulation must involve fictitious trades. Although wash sales, cross trades, and matched orders are often part of manipulative trading,¹⁴⁹ we have consistently held that "[a] finding of manipulation does not hinge on the presence or absence of any particular device usually associated with a manipulative scheme."¹⁵⁰ And while "fictitious trades frequently form the basis of manipulative activity[,] . . . it is not necessary that the transactions in question be fictitious."¹⁵¹ For this reason, we have recognized that market manipulation can occur in the context of open market transactions.¹⁵² Although the trades Respondents engaged in were real, they artificially distorted the price of the stocks involved because Respondents were not participating in the market to find the best available prices but with the intent to raise the price of the stocks.

Respondents further contend that the law judge erred by basing her finding of manipulation on Respondents' intent, arguing that "[i]ntent standing alone cannot create an artificial price and deception in the market place" and that "intent, thought, thinking or even wishing is not a crime."¹⁵³ Respondents' argument misses the mark. The finding of manipulation here is not based solely on their intent to manipulate but also on their conduct (*i.e.*, end-of-day trades designed to raise the stocks' prices) that furthered that manipulative intent. In this context, we have recognized that a market participant's "scienter renders his interference with the market illegal."¹⁵⁴ In other words, although it is Respondents' intent that transforms what might otherwise have been legal trades into illegal manipulation, the violation is not based on intent alone; there must also be trading activity that is consistent with the intent to manipulate.

¹⁴⁷ *Pagel, Inc.*, 1985 SEC LEXIS 988, at *9 (quoting *Edward J. Mawod & Co.*, Exchange Act Release No. 13512, 46 SEC 865, 1977 SEC LEXIS 1811, at *12-13 (May 6, 1977)).

¹⁴⁸ Resp'ts Br. at 15.

¹⁴⁹ A wash sale is a fictitious sale where there is no change in beneficial ownership. A matched order is when identical orders to buy and sell are entered at the same time. Often related to a matched order, a cross trade occurs when a security of one client is bought by another client. See Thomas Lee Hazen, *Law of Securities Regulation* § 14.3[6][B] (1995).

¹⁵⁰ *Swartwood, Hesse, Inc.*, 1992 SEC LEXIS 2412, at *17.

¹⁵¹ Hazen, *supra* note 149, § 14.3[6][A] (citing *Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001)).

¹⁵² See *Kirlin*, 2009 SEC LEXIS 4168, at *57-58; see also *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d at 391 (rejecting a "distinction between open-market manipulation and any other market manipulation").

¹⁵³ Resp'ts Br. at 10.

¹⁵⁴ *Kirlin*, 2009 SEC LEXIS 4168, at *57; see also *Markowski*, 274 F.3d at 528-29 (rejecting the argument that manipulation required fictitious transactions and concluding that the Commission's interpretation of Exchange Act Section 10(b) was reasonable in light of "Congress's determination that 'manipulation' can be illegal solely because of the actor's purpose").

If someone intends to manipulate the market for a security *and* engages in trading that furthers that intent (even if such trading might otherwise be lawful or if the manipulation ultimately is unsuccessful), that person has engaged in illegal market manipulation.

Respondents further argue that they had no motive to manipulate and that "[t]he absence of motive . . . undercuts a claim of manipulation."¹⁵⁵ But proof of motive is not required where there is direct evidence of manipulative intent; it is only where direct evidence of scienter is lacking that circumstantial evidence of intent, such as motive, becomes critical.¹⁵⁶ In this case, there is substantial direct evidence of scienter, including multiple statements by Koch unambiguously showing his intent to mark the close of the stocks in question. Accordingly, the Division is not required to prove Respondents' motive for perpetuating the manipulative scheme.

That said, the evidence in the record shows that Respondents had motive to mark the close. Respondents profited financially from the marking-the-close scheme by increasing the advisory fees paid by clients, even if the increase in fees related to these violations was relatively modest. And contrary to Respondents' suggestion,¹⁵⁷ the fact that Respondents waived fees in the past does not mean that they had no motive to inflate client fees in the second half of 2009. In addition, the evidence suggests that Koch was motivated to artificially raise the prices of the stocks held by KAM's clients to maintain his reputation as a skilled investment adviser. Koch testified that he was particularly concerned about KAM's performance because most of his clients were his friends and associates,¹⁵⁸ and the record shows that Koch was frustrated with the attention that certain clients were paying to their account balances in the wake of the 2009 market downturn.¹⁵⁹ This suggests that Koch, in order to maintain his reputation and avoid losing clients' investments, had a motive to try to boost the performance of his clients' accounts through market manipulation, even if the financial benefit to him through increased fees was modest.¹⁶⁰

Faced with the substantial direct evidence of scienter in the record, Respondents counter that portions of e-mails and telephone conversations have been taken out of context by the law

¹⁵⁵ Resp'ts Br. at 16, 26-27; *see also* Resp'ts Reply Br. at 4.

¹⁵⁶ *See, e.g., Renovitch v. Kaufman*, 905 F.2d 1040, 1046 (7th Cir. 1990) (noting that where there is no "direct evidence of scienter, the court should examine whether there is indirect evidence of scienter" including examining whether there was motive to commit fraud); *Stumpf v. Garvey*, No. 03-CV-1352-PB, 02-MDL-1335-PB, 2005 U.S. Dist. LEXIS 19154, at *35 (D.N.H. Sept. 2, 2005) ("[S]cienter can be established through direct evidence" or by "combin[ing] various facts and circumstances indicating fraudulent intent—including those demonstrating motive and opportunity." (quoting *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 82 (1st Cir. 2002))); *Kas v. Caterpillar, Inc.*, 815 F. Supp. 1158, 1163 (C.D. Ill. 1992) ("If the plaintiff fails to produce direct evidence, the court should examine whether there is indirect evidence of scienter by considering whether the fraud was in the interest of the defendants or whether the defendants had a motive to defraud.").

¹⁵⁷ Resp'ts Br. at 27.

¹⁵⁸ Tr. at 795.

¹⁵⁹ *See, e.g.,* Div. Ex. 121.

¹⁶⁰ *Cf. Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at *56 (Feb. 1, 2010) (noting that a registered representative "derived a personal benefit by keeping [her] clients . . . happy and retaining their business").

judge and the Division.¹⁶¹ We find no merit in this contention. Upon our *de novo* review, we find that, in the context of the entire record, the e-mails and telephone conversations are convincing evidence of Respondents' intent to mark the close. We are unpersuaded by Respondents' attempts to cast these e-mails and telephone conversations in a more benign light by obscuring the context out of which they arose. For example, Respondents consistently suggest that the evidence in the record—including the interactions between Koch and Christanell—supports their contention that the relevant trading by KAM was for the purpose of acquiring difficult-to-obtain shares of stock.¹⁶² But contrary to Respondents' suggestion, the evidence shows that Koch's overriding motivation for the trading at issue was to obtain a particular closing price and not to acquire shares. Not only did Christanell repeatedly testify to this during the hearing,¹⁶³ but Koch's statements in e-mails and telephone conversations show the same:

- "I would like to get a closing price in the 20-25 range, but certainly above 20."¹⁶⁴
- "[I]f you need 5,000 shares, do whatever you have to do—I need to get it above 20, you know, 20 to 25, I'm happy."¹⁶⁵
- "I can go up to 5,000 shares if you need to. . . . Talk if you need more than that."¹⁶⁶
- Regarding Cheviot, Christanell asked, "How much should I buy to get it up there?" Koch responded, "You know, I'd start at the 100, 200 share increment and see how far it moves. . . . I think, since it trades so little, I think you'll be able to get it up pretty fast."¹⁶⁷

¹⁶¹ See Resp'ts Br. at 2, 14; Resp'ts Reply Br. at 1-2.

¹⁶² See Resp'ts Br. at 1-2, 14-15, 25; Resp'ts Reply Br. at 2. In one particularly brazen attempt at spin, Respondents unjustifiably added the following bracketed material to Christanell's apology to Koch at the end of the trading day on December 31, 2009: "I know you wanted it higher [which would get more shares], and I tried." *Id.* at 16; see also Resp'ts Br. at 25 (suggesting that Christanell apologized because "KAM failed to acquire the 5,000 share block of High Country it sought").

¹⁶³ Tr. at 498 ("Q: Okay. For all the trades that we've discussed so far, was Mr. Koch's focus on acquiring a certain number of shares or on getting a particular closing price? A: It was getting—more based on getting the closing price."); Tr. at 504-05 ("Q: So was he trying to acquire 5,000 shares or was he trying to get a particular price? A: He was trying to get a particular price."); Tr. at 511 ("Q: So was the principal focus on acquiring CARV for Mr. Koch, or was the focus on getting a closing price? A: The focus was the closing price, the last trade of the day.").

¹⁶⁴ Div. Ex. 186.

¹⁶⁵ Div. Ex. 189.

¹⁶⁶ *Id.*

¹⁶⁷ Div. Ex. 190.

- Christanell then asked, "Am I alright taking 5,000 [shares] if I have to?", to which Koch replied, "Sure, absolutely . . . you know, on both of them." Christanell affirmed, "Yeah, with [High Country] also."¹⁶⁸
- On Carver, Christanell asked, "I was thinking about just buying like 300 shares at 9.05. Is that alright?", to which Koch replied, "Sure. That's perfect. Just make sure you get a print."¹⁶⁹

Considering all the evidence in its proper context, it is apparent that Koch was focused on getting a particular closing price for these securities and not on acquiring shares. It makes no sense for Koch to say "if you need 5,000 shares, do whatever you have to do" and "I can go up to 5,000 shares if you need to" if his goal was to acquire 5,000 shares. His repeated use of such phrases shows that he was authorizing Christanell to purchase up to 5,000 shares only in order to increase the price of the securities at the close of the market—*not* because he wanted that number (or any particular number) of additional shares.¹⁷⁰

In support of their contention that their trading was for a legitimate investment purpose, Respondents rely heavily upon the testimony of their expert witnesses, particularly Jarrell.¹⁷¹ But this reliance is misplaced. The thrust of Jarrell's testimony was that KAM's trading can be viewed as part of a legitimate strategy to acquire difficult-to-obtain and illiquid stocks. But Jarrell's testimony has serious limitations. Most significantly, Jarrell did not review any of the communications between Koch and Christanell in forming his opinions about whether the trading at issue was manipulative.¹⁷² Although it might be possible to view some of the trading at issue here, standing alone, as consistent with legitimate attempts to obtain illiquid stocks, such an explanation is not convincing if it fails to take into account the strong evidence of Respondents' intent to manipulate. In addition, although Jarrell uses the illiquid nature of the relevant stocks as part of his explanation for why KAM's trading could be legitimate, his opinion fails to take into account that the market for thinly traded stocks is more easily manipulated and thus more often the target of manipulative schemes.¹⁷³

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ Moreover, as the law judge recognized, Koch fails to provide a credible explanation for why he purchased only a few hundred shares of Carver on December 31, 2009, if his goal was to acquire the stock. *Koch*, 2012 SEC LEXIS 1645, at *22.

¹⁷¹ The thrust of the testimony of Respondents' other expert, Schneider, was that the trades in question were consistent with KAM's overall investment program. *See* Resp'ts Br. at 7. That the trades were consistent with KAM's investment program, however, does not mean they were not manipulative. Thus, Schneider's opinion in this regard ultimately is not relevant to the question of Respondents' liability.

¹⁷² Tr. at 1151.

¹⁷³ *See, e.g.,* Steve Thel, *\$850,000 in Six Minutes—The Mechanics of Securities Manipulation*, 79 Cornell L. Rev. 219, 231 (1994) ("[M]anipulation by taking advantage of inelastic supply is likely to be easier with thinly traded securities. In fact, such securities are the subject of many allegedly manipulative schemes.").

Many of the details of Jarrell's testimony are also problematic. With regard to High Country, Jarrell could not rule out marking the close and he conceded that KAM's trades had the effect of raising the price of the stock. Jarrell insisted that it made economic sense to purchase illiquid stocks at the end of the day because of a U-shaped trading curve that applies to stocks in general, which means liquidity is the highest at the start and end of the day. But as Jarrell admitted during the hearing, High Country itself did not have a U-shaped trading curve.¹⁷⁴

Moreover, as the Division points out, Jarrell's explanation does not account for the manner in which KAM acquired High Country stock the vast majority of the time. If it made economic sense for KAM to purchase High Country at the end of the day and end of the month, one would expect to see KAM using such a strategy when acquiring shares. However, as Respondents' expert Schneider testified, between January 7, 1998, and December 28, 2010, KAM purchased High Country on twenty-six separate days but did so on the last trading day of the month only six times—four of which were in 2009 (at issue in this case) and the other two were in 1998.¹⁷⁵ Additionally, trading data from mid-2008 through the end of 2009 show that KAM often purchased High Country shares in the middle of the trading day.¹⁷⁶ Thus, despite Jarrell's opinions about the rationality of KAM's theoretical trading strategy, the evidence shows that KAM did not actually use such a strategy generally for obtaining High Country stock, and Jarrell failed to offer an explanation for this inconsistency.

Furthermore, Jarrell's opinion that KAM's December 31, 2009 trading in Cheviot and Carver did not reflect marking the close is premised on both factual and legal errors. First, Jarrell's opinion relies on his conclusion that KAM's trading did not set the closing price for these stocks on the day in question. But as discussed above, the evidence shows that KAM's trading did set Carver's closing price.¹⁷⁷ More importantly, Respondents can engage in a manipulative scheme to mark the close even if they were ultimately unsuccessful in setting the closing price.¹⁷⁸ And although Jarrell is correct that the price movements with regard to KAM's trading in Cheviot and Carver are smaller than those of High Country, the evidence shows that KAM's trading in these stocks was designed to and did have an impact on the stocks' prices.¹⁷⁹

Respondents further argue that their trading was not manipulative because they used limit orders and "ladder[ed] up" the price of the shares by making small executions to attract potential sellers of a difficult-to-obtain security.¹⁸⁰ Although Respondents may have had a more immediate impact on price by entering a large market order, the evidence shows that they were

¹⁷⁴ Tr. at 1157-59; Resp'ts Ex. 39 at 17.

¹⁷⁵ Resp'ts Ex. 36; Tr. at 1226-27.

¹⁷⁶ See Div. Exs. 321-39.

¹⁷⁷ See *supra* notes 127-131 and accompanying text.

¹⁷⁸ See *supra* note 118. Jarrell testified during the hearing that his opinion was not based on any knowledge of the legal requirements to find a marking-the-close violation. Tr. at 1153.

¹⁷⁹ See *supra* at 18 & 19.

¹⁸⁰ See Resp'ts Br. at 6, 18. Although Respondents write in their brief that Jarrell called this a "laddering" effect, *id.* at 18, Jarrell's testimony does not include this term.

trying to avoid "appearing manipulative."¹⁸¹ And contrary to Respondents' suggestion, the use of limit orders is not inconsistent with a manipulative scheme to mark the close.¹⁸² Respondents also suggest that because neither KAM nor its clients sold the shares at issue their trading cannot be manipulative.¹⁸³ Selling a manipulated stock in order to reap a short term gain based on an elevated price, however, is not the only reason for manipulating a stock's price. We have recognized that investment advisers can use marking-the-close transactions to manipulate the closing value of a managed account at the end of a reporting period—which is exactly the type of manipulative scheme alleged here.¹⁸⁴ Whether the shares are retained thereafter is not relevant to whether the original purchases were part of such a manipulative scheme. And a client's decision not to sell the stock or complain about the manipulated price at which it was purchased does not mean that there was no manipulation to begin with.¹⁸⁵

Respondents argue that the Initial Decision's failure to specifically address the allegation that Respondents did not seek best execution for the trades at issue "can only be read as a failure of proof" for the marking-the-close violations.¹⁸⁶ We disagree. Although the Initial Decision does not use the words "best execution," it did find that "Koch's seeking to mark the close by purchases for the accounts of others at higher prices than would have resulted from legitimate market forces violated his fiduciary duty as an investment adviser,"¹⁸⁷ which is another way of saying the same thing.¹⁸⁸ As Respondents recognize, marking the close and failure to seek best execution are closely related. When an investment adviser attempts to raise the price of the securities he is purchasing for the accounts of his clients, *a fortiori*, he is not seeking to obtain for those clients "the most favorable terms reasonably available under the circumstances."¹⁸⁹

¹⁸¹ Div. Ex. 148.

¹⁸² See *Havill*, 1998 SEC LEXIS 2599, at *16-17 (noting that limit orders can be consistent with marking-the-close manipulation when they cause the price of the stock to rise).

¹⁸³ See Resp'ts Br. at 26; Tr. at 893 (Koch testifying that the allegation of market manipulation was incorrect "because I didn't sell").

¹⁸⁴ See, e.g., *ABN AMRO Inc.*, Exchange Act Release No. 44677, 2001 SEC LEXIS 1621 (Aug. 10, 2001) (settlement of marking-the-close charges); *Parlin*, Exchange Act Release No. 44679, Investment Advisers Act Release No. 1967, 2001 SEC LEXIS 1622 (Aug. 10, 2001) (same).

¹⁸⁵ Cf. *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 SEC LEXIS 3936, at *27 (Nov. 4, 2009) ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct."), *pet. for review denied*, 416 F. App'x 95 (2d Cir. 2011).

¹⁸⁶ Resp'ts Br. at 11.

¹⁸⁷ *Koch*, 2012 SEC LEXIS 1645, at *38.

¹⁸⁸ See, e.g., *Fleet Inv. Advisors, Inc.*, Advisers Act Release No. 1821, 1999 SEC LEXIS 1805, at *24 (Sept. 9, 1999) ("[A]n investment adviser's fiduciary duty includes the requirement to seek the best execution of client securities transactions where the adviser is in a position to direct brokerage transactions.").

¹⁸⁹ *Newton v. Merrill, Lynch, Pierce, Fenner & Smith*, 135 F.3d 266, 270 (3d Cir. 1998). Christanell's affirmative answer to the question of whether the trades in question represented "best execution," Tr. at 591, cannot be squared fully with his testimony that these trades were different from typical trading because they did not involve "try[ing] to purchase them at the best price we can," Tr. at 517. It is possible that Christanell understood the concept of "best execution" differently than obtaining the best available price. In any event, Christanell's opinion about the abstract concept of "best execution" does not carry the weight of the extensive evidence in the record—including

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Thus, marking the close, which here involved attempts to raise the price of a security through end-of-day purchases, is plainly inconsistent with an investment adviser's duty to seek best execution. As the law judge found, the evidence in the record shows that, to the extent they were present, other market participants were obtaining the relevant securities at lower prices than KAM.¹⁹⁰ Koch even instructed Christianell to try to avoid a seller of High Country on December 31, 2009, in order to get a higher closing price.¹⁹¹ We have recognized such conduct as evidence of a failure to seek best execution.¹⁹² Accordingly, we find that the allegations of failure to seek best execution are supported by the evidence in the record and that the law judge's failure to use the words "best execution" in the Initial Decision in no way undermines the marking-the-close violations.¹⁹³

Respondents further argue that only KAM (and not Koch) could be a primary violator because "KAM, not Mr. Koch[,] is the investment adviser."¹⁹⁴ We find, however, that Koch, whose activities as KAM's principal and sole owner extended to "advising others . . . as to the value of securities or as to the advisability of investing in, purchasing or selling securities," falls under the broad definition of "investment adviser" in the Act.¹⁹⁵ As such, he can be liable as a primary violator under Advisers Act Sections 206(1) and 206(2).¹⁹⁶ Similarly, Respondents'

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Christianell's own testimony—that Respondents were not trying to obtain the relevant securities for the best available price but were seeking to raise the price of the securities through their purchases.

¹⁹⁰ See *Koch*, 2012 SEC LEXIS 1645, at *13, *21-22. The record also shows that on September 8, 2009, Koch purchased 10,000 shares of High Country for his personal and family accounts out of the account of one of his other clients for an average of \$11.71 per share. See Div. Ex. 53 at SEC-HUNTLEIGH 3327-28; see also Resp'ts Ex. 39 at 41. Just three weeks later, on September 30, 2009, KAM purchased 2,000 shares of High Country for the account of Alice Smith for an average of \$20.3794 per share. See Div. Ex. 53 at SEC-HUNTLEIGH 3336. Although Smith paid nearly double the price per share for the stock that Koch had paid earlier in the month, Koch insisted that Smith got a "terrific deal." Tr. at 883.

¹⁹¹ Div. Ex. 189. Koch specifically warned Christianell that "if you come in too early, there is a seller" and once the seller is aware of the trading "he'll push out the volume." *Id.*

¹⁹² See *Kirlin*, 2009 SEC LEXIS 4168, at *71-73 (finding a failure to seek best execution where broker, as part of a manipulative scheme, ignored a pending order in the market to prevent a large market transaction from depressing a stock's bid price).

¹⁹³ We reject Respondents' argument that the issue of best execution was somehow forfeited by the Division under the Commission's Rules of Practice, see Resp'ts Reply Br. at 5-6, particularly because it was Respondents who first raised the issue by arguing that the Initial Decision's treatment of the topic constituted a failure of proof for the marking-the-close violations.

¹⁹⁴ Resp'ts Br. at 12 n.5.

¹⁹⁵ 15 U.S.C. § 80b-2(a)(11).

¹⁹⁶ *Warwick Capital Mgmt.*, Advisers Act Release No. 2694, 2008 SEC LEXIS 96, at *31 n. 37 (Jan. 16, 2008) ("We have held that an associated person may be charged as a primary violator under Section 206 where his activities cause him to meet the 'broad' definition of 'investment adviser.'" (quoting *John J. Kenny*, Exchange Act Release No. 47847, 56 SEC 448, 2003 SEC LEXIS 1170, at *63 n. 54 (May 14, 2003))); see also *SEC v. Gotchy*, No. 91-1855, 1992 U.S. App. LEXIS 33647, at *6 (4th Cir. Dec. 28, 1992) (per curiam) (holding that president and fifty percent owner of registered investment adviser qualified as an investment adviser "within the meaning of the Act"); *Abrahamson v. Fleschner*, 568 F.2d 862, 870 (2d Cir. 1977) ("[P]ersons who managed the funds of others for compensation are 'investment advisers' within the meaning of the statute."); *SEC v. Juno Mother Earth Asset Mgmt.*,

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reliance on *Janus Capital Group, Inc. v. First Derivative Traders*,¹⁹⁷ for the proposition that Koch cannot be liable as a primary violator is also misplaced.¹⁹⁸ *Janus* limited the scope of primary liability under Rule 10b-5(b) to the entity that was responsible for making the statements alleged to be fraudulent, and focused specifically on the meaning of the word "make" in Rule 10b-5(b).¹⁹⁹ Respondents, however, are not charged with making statements but with engaging in manipulative and deceptive conduct, and thus *Janus's* holding does not apply.²⁰⁰ For the same reason, *Janus* does not apply to violations of Advisers Act Sections 206(1) and 206(2), which lack any reference to making statements.²⁰¹

C.

The law judge found that Respondents violated Advisers Act Rule 206(4)-7(a), which requires that investment advisers "[a]dopt and implement written policies and procedures reasonably designed to prevent violations by [the adviser] of the Act and the rules that the Commission has adopted under the Act."²⁰² In reaching this conclusion, the law judge found, after finding a violation of the Advisers Act, that "[i]nasmuch as KAM was a one-man firm and Koch was its alter ego as well as its Chief Compliance Officer, it is concluded that KAM and Koch did not implement the anti-manipulation policy and thus violated the rule."²⁰³

We agree that Respondents violated Rule 206(4)-7(a), but on slightly different grounds. Although a violation of the Advisers Act may be evidence that there was a failure to implement a policy against violating the Act, to determine whether there was a Rule 206(4)-7(a) violation, we consider evidence about the steps the adviser took or failed to take to adopt and implement policies and procedures reasonably designed to prevent violations. Upon our *de novo* review of the record, we find that Respondents violated Rule 206(4)-7(a) by failing to implement KAM's policy against manipulative trading.

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LLC, No. 11 Civ. 1778, 2012 U.S. Dist. LEXIS 28114, at *13-15 (S.D.N.Y. Mar. 2, 2012) (holding that individual defendants who were twenty-five percent owners and served as the portfolio manager, CEO and Chief Compliance Officer of a registered investment adviser were "investment advisers" under the Act); *SEC v. Berger*, 244 F. Supp. 2d 180, 192-93 (S.D.N.Y. 2001) (concluding that individual who controlled an investment adviser firm "is also properly labeled an investment adviser within the meaning of the Advisers Act").

¹⁹⁷ 131 S. Ct. 2296 (2011).

¹⁹⁸ See Pet. for Review at 20-21; Resp'ts Br. at 12 n.5.

¹⁹⁹ 131 S. Ct. at 2302.

²⁰⁰ See, e.g., *SEC v. Monterosso*, Nos. 13-10341, 13-10342, 13-10464, 2014 WL 815403, at *5 (11th Cir. Mar. 3, 2014) (declining to extend *Janus* to claims that hinge on deceptive conduct); *SEC v. Pentagon Capital Mgmt., PLC*, 844 F. Supp. 2d 377, 421-22 (S.D.N.Y. 2012) (same), *aff'd in part, vacated in part on other grounds*, 725 F.3d 279 (2d Cir. 2013).

²⁰¹ We are unaware of any ruling extending *Janus* to Advisers Act Section 206 violations.

²⁰² 17 C.F.R. § 275.206(4)-7(a).

²⁰³ *Koch*, 2012 SEC LEXIS 1645, at *39.

KAM's policies and procedures manual expressly prohibited "[e]ngag[ing] in any transaction intended to raise, lower or maintain the price of any Security."²⁰⁴ When asked by his counsel what he did to implement the manual's trading policies, Koch responded, "I made sure that I followed my highest sense of right," and he added that he kept records of "every trade we did."²⁰⁵ But the evidence in the record, as outlined above, shows that Koch—the only KAM employee responsible for implementing the anti-manipulation policy—engaged in multiple transactions specifically intended to raise the price of the securities KAM was purchasing. The multiple instances of intentionally manipulative trading by Respondents belie Koch's claim that he implemented the policy through ethical behavior and, in fact, demonstrate a complete failure to meaningfully implement KAM's policy against manipulative trading. Moreover, merely keeping records of KAM's trading is insufficient to implement an anti-manipulation policy. For these reasons, we find that Respondents violated Rule 206(4)-7(a).

IV.

A. Censure and collateral bar

The Division requests that we censure KAM and impose a collateral bar upon Koch. Advisers Act Section 203(e), among other things, authorizes us to censure an investment adviser for willfully violating the securities laws.²⁰⁶ Advisers Act Section 203(f) authorizes us to bar a person associated with an investment adviser from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization if the person has willfully violated the securities laws.²⁰⁷

In determining the need for sanctions in the public interest, we consider, among other things, (i) the egregiousness of the respondent's actions; (ii) the degree of scienter involved; (iii) the isolated or recurrent nature of the infraction; (iv) the respondent's recognition of the wrongful nature of his or her conduct; (v) the sincerity of any assurances against future violations; and (vi) the likelihood that the respondent's occupation will present opportunities for future violations.²⁰⁸ Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."²⁰⁹

Respondents' insistence to the contrary notwithstanding,²¹⁰ their conduct was egregious. Market manipulation is one of the most egregious securities law violations.²¹¹ We have held that

²⁰⁴ Div. Ex. 279.

²⁰⁵ Tr. at 822.

²⁰⁶ 15 U.S.C. § 80b-3(e).

²⁰⁷ 15 U.S.C. § 80b-3(f).

²⁰⁸ See *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

²⁰⁹ *Disraeli*, 2007 SEC LEXIS 3015, at *61.

²¹⁰ Resp'ts Br. at 28.

²¹¹ See *Robert J. Prager*, Exchange Act Release No. 51974, 2005 SEC LEXIS 1558, at *55 (July 6, 2005) (noting that manipulation is a "very grave violation," and that its elimination is "one of the central goals of the federal securities

"[c]onduct that violates the antifraud provisions 'is especially serious and subject to the severest of sanctions.'"²¹² Respondents also acted with scienter. As detailed above, the evidence shows that Respondents engaged in end-of-month, end-of-day trading with the specific intent to manipulate the market by marking the close of the securities they purchased. This conduct was recurrent, with Respondents attempting to mark the close of one or more securities at least twice in the second half of 2009. Respondents' marking-the-close scheme ended after regulators began investigating suspicious end-of-day trades, but we have repeatedly declined to credit a respondent whose misconduct stopped only after it was detected by regulators.²¹³

Respondents point to their "unblemished record of years of service to firm clients" and "deep respect for the rule of law" to show that they will not commit future violations.²¹⁴ We have concerns, however, about the sincerity of their assurances given the degree of scienter involved. We also find troubling their continued insistence that they have done nothing wrong and that their trading activity was completely legitimate, despite substantial evidence that they intentionally sought to raise the price of the securities they were purchasing to obtain a particular closing price. Respondents also insist there is "little likelihood of recurrence" because they "currently have no advisory clients" and Koch is "retired."²¹⁵ We note, however, that Koch apparently still manages at least some client accounts,²¹⁶ and as the Division argues,²¹⁷ absent a bar there is nothing to prevent Koch from coming out of retirement and participating in the industry.

The law judge declined to impose a collateral bar solely on the ground that, in her view, a collateral bar amounted to imposing a "new sanction retroactively."²¹⁸ At the time of her decision, the law judge did not have the benefit of our decision in *John W. Lawton*.²¹⁹ For the reasons we explained in *Lawton*, the imposition of a collateral bar in this case is not impermissibly retroactive.²²⁰ The Dodd-Frank Act amended Advisers Act Section 203(f) to

(...continued)

laws" (citing *R.B. Webster Inv., Inc.*, Exchange Act Release No. 34659, 51 SEC 1269, 1994 SEC LEXIS 2868, at *22(Sept. 13, 1994)).

²¹² *Disraeli*, 2007 SEC LEXIS 3015, at *66 (quoting *Marshall E. Melton*, Exchange Act Release No. 48228, 56 SEC 695, 2003 SEC LEXIS 1767, at *29-30 (July 25, 2003)).

²¹³ See *Gregory O. Trautman*, Exchange Act Release No. 61167, 2009 SEC LEXIS 4173, at *78 (Dec. 15, 2009) (considering the nature of the misconduct and finding bar appropriate where, among other things, misconduct stopped only after it was detected by regulators); *Joseph John VanCook*, Exchange Act Release No. 61039A, 2009 SEC LEXIS 3872, at *61-62 (Nov. 20, 2009) (same), *petition denied*, 653 F.3d 130 (2d Cir. 2011); *Ofirfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 SEC LEXIS 2545, at *45 (Nov. 3, 2006) (same).

²¹⁴ Resp'ts Br. at 28-29.

²¹⁵ Resp'ts Br. at 28.

²¹⁶ Tr. at 806-08.

²¹⁷ Div. Br. at 39.

²¹⁸ *Koch*, 2012 SEC LEXIS 1645, at *48 n.29. The law judge made no determination that a collateral bar would not be in the public interest.

²¹⁹ Advisers Act Release No. 3513, 2012 SEC LEXIS 3855 (Dec. 13, 2012).

²²⁰ *Id.* at *20-38.

authorize us to bar persons associated with an investment adviser from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, whereas Section 203(f) previously provided only for an investment adviser associational bar.²²¹ Although Congress enacted the Dodd-Frank amendment after Koch committed his misconduct, we held in *Lawton* that such collateral bars are not impermissibly retroactive because the decision to impose such a bar is based on a present assessment of "whether such a remedy is necessary or appropriate to protect investors and markets from the risk of future misconduct."²²²

Based upon such an assessment, we conclude that it is in the public interest to censure KAM and impose a collateral bar on Koch from associating with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. Koch's intentional manipulation of the securities market raises significant doubts about his fitness to remain in the securities industry in any capacity. As we have recognized previously, market manipulation "'attacks the very foundation and integrity of the free market system' and 'runs counter to the basic objectives of the securities laws.'"²²³ Because "[t]he securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence,"²²⁴ it is essential that the "highest ethical standards prevail in every facet of the securities industry."²²⁵ The antifraud provisions that Koch violated apply broadly to the conduct of all participants in the securities industry. In addition, Koch's violations were neither technical in nature nor based solely on his status as an investment adviser. For all of these reasons, we believe that a collateral bar is in the public interest.

B. Cease-and-desist order

Exchange Act Section 21C and Advisers Act Section 203(k) authorize us to issue a cease-and-desist order against any person who "is violating, has violated, or is about to violate" the

²²¹ Prior to Dodd-Frank, the Division could seek—under the Exchange Act—to bar a person with an existing investment adviser suspension or bar from associating with a broker, dealer, municipal securities dealer, or transfer agent (but not from associating with a municipal advisor or a nationally recognized statistical rating organization) in a separate proceeding if the person was seeking such an association. See *Lawton*, 2012 SEC LEXIS 3855, at *17. The Division submitted in its brief that that it was not authorized to seek an order barring Koch from association with a municipal advisor or a nationally recognized statistical rating organization, Div. Br. at 41, presumably because such bars were completely unavailable prior to Dodd-Frank. In light of *Lawton*, however, a full collateral bar is an available sanction.

²²² *Lawton*, 2012 SEC LEXIS 3855, at *32.

²²³ *Yoshikawa*, 2006 SEC LEXIS 948, at *32 (quoting *Pagel, Inc.*, 1985 SEC LEXIS 988, at *21).

²²⁴ *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 SEC LEXIS 2238, at *28 (Sept. 26, 2007); see also *Paul K. Grassi, Jr.*, Exchange Act Release No. 52858, 2005 SEC LEXIS 3072, at *9 (Nov. 30, 2005); *Frank Kufrovich*, Exchange Act Release No. 45437, 55 SEC 616, 2002 SEC LEXIS 3399, at *17 (Feb. 13, 2002); *William F. Lincoln*, Exchange Act Release No. 39629, 53 SEC 452, 1998 SEC LEXIS 193, at *29 (Feb. 9, 1998); *Philip S. Wilson*, Exchange Act Release No. 23348, 48 SEC 511, 1986 SEC LEXIS 1332, at *14 (June 19, 1986); *Walter H. T. Seager*, Exchange Act Release No. 20831, 47 SEC 1040, 1984 SEC LEXIS 1836, at *8 (Apr. 6, 1984).

²²⁵ *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186-87 (1963) (internal citation omitted).

Acts or the rules promulgated thereunder.²²⁶ In determining whether a cease-and-desist order is appropriate, we consider the *Steadman* factors identified above as well as "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings."²²⁷ In this context, we also consider the risk of future violations.²²⁸ Although "'some' risk is necessary, it need not be very great to warrant issuing a cease-and-desist order. Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation."²²⁹

Based on our consideration of the relevant factors, we conclude that a cease-and-desist order is appropriate. As discussed above, Respondents' conduct involved egregious violations of the securities laws, Respondents acted with scienter, the violations were recurrent, and Respondents continue to insist—despite strong evidence to the contrary—that they were not attempting to mark the close and that their trading was completely lawful. The violations occurred in 2009 and the direct harm to Respondents' clients from the manipulative scheme was relatively small, but we believe Respondents' manipulation represented a serious threat to the integrity of the markets for these thinly traded stocks. And although Koch insists that he would "respect and abide by the ruling" of the Commission,²³⁰ we find reasons to question these assurances, particularly in light of Respondents' continued and strenuous insistence that their trading was wholly legitimate. Accordingly, we find there is sufficient risk of future violations to order Respondents to cease-and-desist from committing or causing any violations or future violations of the antifraud provisions.

C. Disgorgement

Exchange Act Section 21C(e) and Advisers Act Section 203(j) authorize the Commission to order the disgorgement of ill-gotten gains.²³¹ An order for disgorgement "is intended primarily to prevent unjust enrichment."²³² Thus, "the amount of disgorgement should include all gains flowing from the illegal activities," but calculating the amount of disgorgement

²²⁶ 15 U.S.C. §§ 78u-3, 80b-3(k).

²²⁷ *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 54 SEC 1135, 2001 SEC LEXIS 98, at *116 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002); *see also Herbert Moskowitz*, Exchange Act Release No. 45609, 55 SEC 658, 2002 SEC LEXIS 693, at *35-36 (Mar. 21, 2002).

²²⁸ *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *102-03.

²²⁹ *Id.* ("To put it another way, evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease and desist.").

²³⁰ Resp'ts Br. at 29.

²³¹ 15 U.S.C. §§ 78u-3(e), 80b-3(j).

²³² *Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009) (quoting *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000)); *see Michael David Sweeney*, Exchange Act Release No. 29884, 50 SEC 761, 1991 SEC LEXIS 2455, at *17 (Oct. 30, 1991) ("[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched.").

"requires only a reasonable approximation of profits causally connected to the violation."²³³ We have held that "[o]nce the Division shows that its disgorgement figure is a reasonable approximation of the amount of unjust enrichment, the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation."²³⁴ The law judge ordered Respondents to disgorge \$4,169.78. We agree that this is a reasonable approximation of Respondents' ill-gotten gains.

To calculate the disgorgement amount, the Division undertook to quantify the difference between the quarterly fees KAM charged its clients in the third and fourth quarter of 2009 and the amount those fees would have been had Respondents not engaged in manipulation. In making its calculation, the Division relied upon evidence regarding how Huntleigh priced securities at month-end for account holders. If there was no trading on the last trading day of the month, Huntleigh priced the security at the last bid of the day. If there was trading on the last day of the month, Huntleigh valued the holding at the publicly-reported closing price. Thus, when Respondents' trading constituted all of the trading volume on the last day of the month, the Division used the last bid before Respondents began trading, and when Respondents' trading constituted less than all of the trading volume, the Division used the last reported non-KAM trade before the close. Once the Division calculated the difference between the closing price that was established by Respondents' manipulative trades in High Country on September 30 and December 31 and in Carver on December 31 and an estimate of the closing price that would have been reported to Respondents' clients on those days if Respondents had not traded, the Division multiplied that amount by the number of High Country shares held by KAM clients on September 30 and the number of High Country and Carver shares held by KAM clients on December 31.²³⁵ This amount represented the total dollar increase in KAM client holdings caused by Respondents' manipulative trading on September 30 and December 31, 2009. The Division then multiplied this amount by KAM's quarterly advisory fee of 0.25% to determine the increase in advisory fees charged to KAM clients for the two relevant quarters. The Division initially calculated this amount to be \$5,819.93. After hearing testimony established that certain accounts (principally Koch personal and family accounts) were not charged an advisory fee, the Division revised its disgorgement calculation to \$4,288.08, excluding the non-fee-paying

²³³ *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1113-14 (9th Cir. 2006) (quotation omitted); *Laurie Jones Canady*, Exchange Act Release No. 41250, 54 SEC 65, 1999 SEC LEXIS 669, at *38 n.35 (Apr. 5, 1999) (noting that "courts have held that '[t]he amount of disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation [and that] any risk of uncertainty [in calculating disgorgement] should fall on the wrongdoer whose illegal conduct created that uncertainty'" (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996) (alterations in original and internal quotation marks omitted)); see also *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) (noting that, when calculating disgorgement, "separating legal from illegal profits exactly may at times be a near-impossible task").

²³⁴ *Eric J. Brown*, Exchange Act Release No. 66469, 2012 SEC LEXIS 636, at *50 (Feb. 27, 2012) (citing *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006)); see also *Zacharias*, 569 F.3d at 473 (noting that, where disgorgement cannot be exact, the "well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty"); *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004) ("Exactitude is not a requirement; '[s]o long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty.'" (quoting *SEC v. Warde*, 151 F.3d 42, 50 (2d Cir. 1998))).

²³⁵ Div. Br. at 43-44.

accounts that had been identified during the hearing. In their post-hearing brief, Respondents argued that, based on the Division's methodology, the excessive fees should only be \$4,169.78. The Division accepted Respondents' lower number, "[r]ecognizing that disgorgement need only reflect a reasonable approximation of the ill-gotten gains."²³⁶ This amount was then adopted by the law judge in the Initial Decision.

Respondents argue that the disgorgement amount ordered by the law judge is incorrect because it "ignores the manner in which KAM actually calculates advisory fees."²³⁷ According to Respondents, when an illiquid stock did not trade on the last day of a quarter, KAM, unlike Huntleigh, did not use the bid price to value the stock for its quarterly fee calculation. Instead, KAM "estimate[d] the value of the security to calculate the fees and disclose[d] that fact to the clients."²³⁸ Neither before the law judge nor before us, however, have Respondents put forward any evidence concerning their methodology for estimating the value of the securities in question, nor have they provided an explanation of how their methodology would differ from the one used by the Division.²³⁹ We believe that the Division's methodology—based on an estimate of values that would have been reported to KAM's clients by Huntleigh—represents a reasonable approximation of Respondents' ill-gotten gains. And Respondents have not met their burden of showing that the Division's estimate is not a reasonable approximation—particularly because it is Respondents' manipulative trading that is the basis for the underlying uncertainty in estimating the value of the securities absent manipulation.²⁴⁰ Accordingly, we order Respondents, jointly and severally, to disgorge \$4,169.78, plus prejudgment interest.²⁴¹

²³⁶ Div. Br. at 44.

²³⁷ Resp'ts Br. at 14. In their petition for review—but not in their brief—Respondents also argued that the disgorgement amount was incorrect because it included fees for October and November 2009, for which the law judge failed to find violations. Pet. for Review at 10. We agree with Division, however, that his argument is baseless because KAM charged its clients fees only quarterly, not monthly. KAM based its fees on the value of its clients' accounts at the end of the quarter. Thus, the relevant days for determining client fees for the last two quarters of 2009 were the last trading days of September and December.

²³⁸ Resp'ts Br. at 14.

²³⁹ Respondents' brief insists that KAM "does not use [Huntleigh's] methodology to calculate value," but it contains no explanation of how KAM did estimate the price of securities that were not traded on the final day of a quarter. *Id.* at 14 n.6.

²⁴⁰ *See supra* note 234.

²⁴¹ *David R. Lehl*, Securities Act Release No. 8102, 55 SEC 843, 2002 SEC LEXIS 1796, at *52 (May 17, 2002) ("Numerous courts recognize that 'where two or more individuals or entities collaborate or have a close relationship in engaging in the violations of securities laws, they have been jointly and severally liable for the disgorgement of illegally obtained proceeds.'" (quoting *SEC v. First Pacific Bancorp.*, 142 F.3d 1186, 1191 (9th Cir. 1998)); *Terence Michael Coxon*, Exchange Act Release No. 48385, 56 SEC 934, 2003 SEC LEXIS 2013, at *64 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005); 17 C.F.R. § 201.600(b) (stating that "[i]nterest on the sum to be disgorged shall be computed at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), and shall be compounded quarterly").

D. Civil monetary penalty

Advisers Act Section 203(i) authorizes the Commission to impose civil monetary penalties for willful violations of the securities laws.²⁴² In considering whether a civil penalty is in the public interest, the Commission may consider (i) whether the act or omission involved fraud; (ii) whether the act or omission resulted in harm to others; (iii) the extent to which any person was unjustly enriched, taking into account restitution made to injured persons; (iv) whether the individual has committed previous violations; (v) the need to deter such person and others from committing violations; and (vi) such other matters as justice may require.²⁴³ Second-tier penalties are appropriate if the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and third-tier penalties are appropriate if, in addition to "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," the violation "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed" the violation.²⁴⁴

We find that the \$75,000 second-tier penalty ordered against Respondents by the law judge is appropriate in this case. As elaborated above, Respondents' marking-the-close scheme involved fraud, deceit, and manipulation under the securities laws. Their conduct harmed both their advisory clients (who received higher fees and overvalued securities) as well as other participants in the markets they were manipulating (who received false information about the value of the relevant securities). As the disgorgement analysis demonstrates, Respondents were also unjustly enriched through their misconduct. Given the serious nature of the violations of the antifraud provisions of the Exchange Act and Advisers Act, a second-tier civil penalty is appropriate to deter future misconduct by Respondents and others.

The Division argues that a third-tier penalty is called for because Respondents' "conduct led to the risk of substantial losses to other persons."²⁴⁵ We disagree. Although Respondents' marking-the-close scheme may have resulted in losses to KAM's advisory clients who purchased shares at inflated prices, the Division has not shown that, to the extent there were such losses, they were substantial. Moreover, the Division has not adequately demonstrated that the risk of substantial losses to these clients or to other market participants is significant enough to warrant third-tier penalties. Accordingly, we order Respondents to pay a \$75,000 second-tier penalty, for which they are jointly and severally liable.²⁴⁶

²⁴² 15 U.S.C. § 80b-3(i). As we have explained, Respondents' violations were willful in this context. *See supra* note 139.

²⁴³ *Id.* § 80b-3(i)(3).

²⁴⁴ *Id.* § 80b-3(i)(2).

²⁴⁵ Div. Br. at 46.

²⁴⁶ Because Koch is the sole owner and principal of KAM, and it is through Koch's conduct that KAM's violations occurred, joint and several liability is appropriate. *See Zion Capital Mgmt. LLC*, Exchange Act Release No. 48904A, 57 SEC 99, 2003 SEC LEXIS 2939, at *35-36 (Dec. 11, 2003) (imposing a joint-and-several civil penalty on an advisory firm and its president and sole owner).

An appropriate order will issue.²⁴⁷

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN; Commissioners GALLAGHER and PIWOWAR concurring in part and dissenting with respect to the bars from association with municipal advisors and nationally recognized statistical rating organizations).

Lynn M. Powalski
Deputy Secretary

²⁴⁷ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 72179 / May 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3836 / May 16, 2014

INVESTMENT COMPANY ACT OF 1940
Rel. No. 31047 / May 16, 2014

Admin. Proc. File No. 3-14355

In the Matter of

DONALD L. KOCH and KOCH ASSET
MANAGEMENT, LLC
c/o Thomas O. Gorman
Dorsey & Whitney LLP
1801 K Street, NW, Suite 750
Washington, DC 20006

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Koch Asset Management, LLC ("KAM") is censured for violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7 thereunder; and it is further

ORDERED that Donald L. Koch be barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and it is further

ORDERED that KAM and Koch cease and desist from committing or causing any violations or future violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-7 thereunder; and it is further

ORDERED that KAM and Koch, jointly and severally, disgorge \$4,169.78, plus prejudgment interest of \$695.89, such prejudgment interest calculated beginning from October 1, 2009, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that KAM and Koch pay a civil money penalty of \$75,000, for which they are jointly and severally liable.

Payment of the amounts to be disgorged and the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Lynn M. Powalski
Deputy Secretary