

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74803 / April 23, 2015

Admin. Proc. File No. 3-15764

In the Matter of
GARY L. MCDUFF

ORDER REMANDING FOR ADDITIONAL
PROCEEDINGS

An administrative law judge barred Gary L. McDuff by summary disposition from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934.¹ As explained below, we find that the existing record does not contain sufficient evidence to establish one of the statutory requirements for a proceeding under Exchange Act Section 15(b)(6) or to support a sanctions analysis. We therefore remand this matter to the law judge for further proceedings.

Exchange Act Section 15(b)(6) authorizes the Commission to determine whether a sanction is in the public interest if two statutory requirements are met: (i) the respondent is associated, is seeking to become associated, or, at the time of the alleged misconduct, was associated or was seeking to become associated with a broker or dealer, and (ii) the respondent meets at least one of several potential bases for a proceeding, including that respondent has been enjoined from engaging in or continuing any conduct or practice in connection with acting as a broker-dealer.² The law judge found that there was no genuine issue of material fact that these two prerequisites were met and determined that a collateral bar was in the public interest.

¹ *Gary L. McDuff*, Initial Decision Release No. 663, 2014 WL 4384138 (Sept. 5, 2014). McDuff appeals the law judge's initial decision, and the Division of Enforcement moves for summary affirmance.

² *See* 15 U.S.C. § 78o(b)(6); *Martin R. Kaiden*, Securities Exchange Act Release No. 41629, 54 SEC 194, 1999 WL 507860, at *7 (July 20, 1999) ("Under Exchange Act Section 15(b)(6), we may institute administrative proceedings against an associated person of a broker-dealer based on an injunction from engaging in or continuing any conduct or practice in connection with acting as a broker-dealer."). A person who acts as an unregistered broker-dealer is "associated" with a broker-dealer for the purposes of Section 15(b). *See Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 WL 3864511, at *8 (July 26, 2013) (holding that
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But the law judge erred when he found that there was no genuine issue of material fact concerning the first prerequisite. The law judge further erred when he based his sanctions determination on the allegations in a civil complaint on which McDuff defaulted and a superseding indictment on which a jury returned a general verdict. On the record before us, the allegations in neither document have the necessary preclusive effect to make those determinations.

I. The Commission instituted these proceedings against McDuff after he was enjoined by default judgment from violating the securities laws and was convicted in a related criminal proceeding.

The Commission instituted this follow-on proceeding on February 21, 2014, alleging that McDuff had been permanently enjoined by a U.S. district court from future violations of Securities Act Sections 5(a), 5(c), and 17(a);³ Exchange Act Sections 10(b) and 15(a);⁴ and Exchange Act Rule 10b-5.⁵ The injunction stemmed from a civil complaint that the Commission filed on March 26, 2008.⁶ The Commission alleged in the civil complaint that McDuff was the "mastermind" behind a wide-ranging scheme to defraud investors. McDuff allegedly created and operated Lancorp Financial Fund Business Trust ("Lancorp Fund"), an entity that McDuff misrepresented to investors as being an unregistered, closed-end, and non-diversified management investment company that invested solely in highly rated debt securities. But instead of investing in high-grade debt securities as promised, McDuff allegedly directed Lancorp Fund to invest in Megafund Corporation, a Ponzi scheme. McDuff also allegedly devised a scheme to circumvent a prohibition against Lancorp Fund's paying certain commissions by having an associate covertly pay McDuff and another associate more than \$300,000.

McDuff failed to answer the complaint, and the Commission moved for default judgment. The district court granted the Commission's motion and enjoined McDuff from further violations

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it is "well established that [the Commission is] authorized to sanction an associated person of an unregistered broker-dealer or investment adviser in a follow-on administrative proceeding"); *Vladislav Steven Zubkis*, Exchange Act Release No. 52876, 2005 WL 3299148, at *6 (Dec. 2, 2005) (barring an associated person of an unregistered broker-dealer from associating with any broker-dealer and from participating in any penny stock offering).

³ 15 U.S.C. §§ 77e(a), 77e(c), 77q(a).

⁴ *Id.* §§ 78j(b), 78o(a).

⁵ 17 C.F.R. § 240.10b-5.

⁶ Complaint, *SEC v. McDuff*, No. 3-08-cv-526 (N.D. Tex. Mar. 26, 2008).

of the federal securities laws and ordered him to disgorge \$136,336 plus \$65,004 in prejudgment interest and to pay a civil penalty of \$125,000.⁷ McDuff did not appeal.

On August 13, 2009, McDuff was indicted in a related criminal proceeding, based on his involvement in the Lancorp Fund and Megafund.⁸ He was charged with laundering monetary instruments and conspiracy to commit wire fraud. A jury found McDuff guilty on both counts pursuant to a general jury verdict. On April 16, 2014, the district court sentenced McDuff to 300 months in prison and a three-year term of supervised release and ordered him to pay \$6,563,179 in restitution. McDuff appealed his conviction; that appeal is pending before the U.S. Court of Appeals for the Fifth Circuit.

II. The law judge erred in relying on the default judgment as a basis for finding that McDuff acted as an unregistered broker or dealer at the time of his alleged misconduct.

After the Commission instituted these proceedings, McDuff and the Division both moved for summary disposition. The law judge denied McDuff's motion and granted the Division's motion, finding that there was no issue of material fact that McDuff had acted as an unregistered broker or dealer at the time of his alleged misconduct.⁹ The law judge based this finding on "the district court's ruling that the Commission was entitled to a permanent injunction against McDuff for violating Exchange Act Section 15(a)(1) [which prohibits one from acting as an unregistered broker]."¹⁰ The law judge also relied on two affidavits that McDuff introduced from alleged victims, which the law judge quoted as saying that McDuff "plac[ed] Lancorp Fund money into the Megafund."¹¹

McDuff challenges the law judge's finding that he acted as a broker-dealer, claiming instead that he was merely another investor in the two funds. Normally a respondent in a follow-on proceeding cannot challenge a district court's earlier findings. But that is not necessarily the case where, as here, the underlying proceeding was decided by default. The Supreme Court has explained that, "[i]n the case of a judgment entered by . . . default, none of the issues is actually litigated. Therefore [issue preclusion, or collateral estoppel] does not apply with respect to any

⁷ Final Default Judgment, *SEC v. McDuff*, No. 3:08-cv-526 (N.D. Tex. Feb. 22, 2013).

⁸ Superseding Indictment, *United States v. Reese*, No. 4:09-cr-90 (E.D. Tex. Aug. 13, 2009).

⁹ The law judge also found that McDuff did not dispute that he had been enjoined from future violations of the securities laws.

¹⁰ *McDuff*, 2014 WL 4384138, at *3 (citing 15 U.S.C. § 78o(a)(1) (providing that it is unlawful "to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless one is a registered broker or dealer or associated with a registered broker or dealer)).

¹¹ *Id.* at *3 (quoting affidavits in respondent's Exhibit 8).

issue in a subsequent action."¹² The district court's default judgment therefore does not, by itself, provide an adequate basis for finding that McDuff acted as an unregistered broker-dealer.¹³

Although the Commission has given preclusive effect to substantive findings that have *accompanied* the entry of default,¹⁴ the record here contains no such additional evidence that establishes whether McDuff was "engaged in the business of effecting transactions in securities for the accounts of others."¹⁵ The law judge quotes two affidavits as stating that McDuff placed Lancorp money into the Megafund, but the quotes are taken out of context. Both affidavits state that the affiants were "aware that . . . GARY MCDUFF [has] been, and [is] now being prosecuted for placing Lancorp Fund money into the Megafund, and losing it the same way [the affiants'] money was lost." The affiants therefore recite only the government's accusation that McDuff transferred money from one fund to another. And even if the affiants had personal knowledge of such a transfer, determining whether McDuff was acting as an unregistered broker-dealer involves the consideration of several factors in addition to his handling of funds.¹⁶

¹² *Arizona v. California*, 530 U.S. 392, 414 (2000) (quoting RESTATEMENT (SECOND) OF JUDGMENTS, § 27 cmt. e, p. 257 (1982)).

¹³ *Cf. Don Warner Reinhard*, Exchange Act Release No. 61506, 2010 WL 421305, at *4 (Feb. 4, 2010) ("*Reinhard I*") (remanding matter for further proceedings where initial decision relied on a default judgment as the basis for determining appropriate sanctions).

¹⁴ *See, e.g., Harold F. Harris*, Exchange Act Release No. 53122A, 58 SEC 1118, 2006 WL 89510, at *5 (Jan. 13, 2006) (giving preclusive effect to findings of violations that, although "termed a default," were based on the district court's consideration of respondents' substantive defenses and specific findings of fact); *Thomas J. Donovan*, Exchange Act Release No. 52883, 58 SEC 1032, 2005 WL 3299159, at *4–5 (Dec. 5, 2005) (imposing sanctions based on a default injunction where the law judge conducted a hearing and accepted documents and testimony that related to the misconduct at issue and the public interest); *Lamb Bros., Inc.*, Exchange Act Release No. 14017, 46 SEC 1053, 1977 SEC LEXIS 715, at *12 (Oct. 3, 1977) (imposing sanctions based on a default injunction where the "allegations made in the injunctive suit [were] remade" in the administrative proceeding and "an evidentiary record with respect to those matters was developed").

¹⁵ 15 U.S.C. § 78c(a)(4) (defining "broker"); *see also id.* § 78c(a)(5) (defining "dealer" generally as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise").

¹⁶ *See, e.g., SEC v. Bravata*, 3 F. Supp. 3d 638, 660 (E.D. Mich. 2014) (stating that "[f]actors that may qualify an individual as a broker [include] regular participation in securities transactions, employment with the issuer of the securities, payment by commission as opposed to salary, history of selling the securities of other issuers, involvement in advice to investors and active recruitment of investors" (quoting *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005))); *SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011) (stating that determining whether a person qualifies as a broker under Section 15(a) involves considering an array of non-exclusive factors); *Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *18

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We accordingly remand this matter to the law judge to admit and consider additional evidence from the criminal proceeding or any other relevant source to determine whether McDuff was acting as a broker or dealer at the time of his misconduct.

III. The law judge erred in relying on allegations in the civil complaint and superseding indictment when determining that a collateral bar was in the public interest.

The law judge determined that a full collateral bar was in the public interest by relying on the allegations in the civil complaint and in the superseding indictment. Such allegations may, in certain circumstances, provide a basis for assessing whether sanctions are appropriate, but as discussed above, the allegations in the civil complaint do not have the necessary preclusive effect here. As explained below, nor do the allegations in the superseding indictment.

The law judge interpreted two Commission decisions—*Don Warner Reinhard II* and *Ross Mandell*—as allowing him to adopt allegations from an indictment without needing to "engage in a particularized collateral-estoppel analysis, as might be required in other contexts."¹⁷ But in *Reinhard II*, we did not rely on an indictment when determining that a bar was in the public interest. We relied on a plea agreement, in which the respondent expressly "waived any objections he may have had to the facts set out in the latter agreement and became bound by the facts recited therein."¹⁸ McDuff has not pleaded guilty, nor has he made other concessions or acknowledgements that might have preclusive effect here. And although we referenced a superseding indictment when conducting our sanctions analysis in *Mandell*, we did not hold that allegations in an indictment automatically have preclusive effect. Rather, we stated simply that our "summary of Mandell's conduct draws from the allegations in the superseding indictment underlying his criminal conviction."¹⁹ Our analysis also referenced a district court order, which

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(Feb. 20, 2015) (stating that "[a]ctivities that are indicative of being a broker include holding oneself out as a broker-dealer, recruiting or soliciting potential investors, handling client funds and securities, negotiating with issuers, and receiving transaction-based compensation").

¹⁷ *McDuff*, 2014 WL 4384138, at *5 n.10 (citing *Don Warner Reinhard*, Exchange Act Release No. 63720, 2011 WL 121451 (Jan. 14, 2011) ("*Reinhard II*") and *Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416 (Mar. 7, 2014)).

¹⁸ *Reinhard II*, 2011 WL 121451, at *7 (citing *United States v. Lomeli-Mences*, 567 F.3d 501, 507 (9th Cir. 2009) (holding that defendant could not challenge facts on appeal after admitting to those facts in "both his written plea agreement and oral change of plea proceedings")); cf. *United States v. Newman*, 148 F.3d 871, 876 (7th Cir. 1998) (holding that defendant was deemed to have admitted facts in signed plea agreement and waived any subsequent challenge to them).

¹⁹ *Mandell*, 2014 WL 907416, at *2 n.13 (emphasis added) (citing Superseding Indictment, *United States v. Mandell*, No 1:09-cr-0062 (S.D.N.Y. Dec. 14, 2010)).

made express findings about what the jury would have concluded from the evidence presented at Mandell's criminal trial.²⁰

Here, a jury convicted McDuff of conspiracy to commit wire fraud in a general verdict, which the jury could do without making a specific finding as to which, if any, of the alleged overt acts McDuff committed.²¹ And although the jury also returned a general verdict that McDuff committed money laundering, that verdict generally establishes only that McDuff caused a Megafund-controlled account to transfer illegal proceeds to a Lancorp-controlled account with the intent to promote the wire fraud.²² Under these circumstances, the law judge erred in relying on the allegations in the superseding indictment in his sanctions analysis.²³ Therefore, if the law judge first determines that the statutory basis for imposing remedial

²⁰ See *id.* at *5 n.24 (citing Order Denying Motions for Acquittal or New Trial, *United States v. Mandell*, No 1:09-cr-0062 (S.D.N.Y. Nov. 2, 2011)).

²¹ See *United States v. Jones*, 733 F.3d 574, 584 (5th Cir. 2013) (holding that conspiracy to commit wire fraud does not require that the defendant committed an overt act); *cf. United States v. Wainer*, 211 F.2d 669, 672 (7th Cir. 1954) (stating that, "[o]bviously a general verdict of guilty, or for that matter the entry of a plea of guilty, on a count for conspiracy does not determine which of the particular means charged in the indictment were used to effectuate the conspiracy").

²² See *United States v. Valuck*, 286 F.3d 221, 225 (5th Cir. 2002) (stating that, to prove a conviction for money laundering under the relevant statute, the government must prove that "(1) the financial transaction in question involves the proceeds of unlawful activity, (2) the defendant had knowledge that the property involved in the financial transaction represented proceeds of an unlawful activity, and (3) the financial transaction was conducted with the intent to promote the carrying on of a specified unlawful activity").

²³ *Cf. Reinhard I*, 2010 WL 421305, at *4 (concluding that the Commission's sanctions analysis would be assisted by the introduction of additional evidence on remand where the law judge had relied on a default injunction when determining sanctions).

sanctions is met, we direct the law judge on remand to admit and consider additional evidence to determine whether imposing such sanctions against McDuff is in the public interest.

Accordingly, it is ORDERED that the Division's motion for summary affirmance is denied; and it is further

ORDERED that the initial decision entered against McDuff be vacated; and it is further

ORDERED that this case be remanded to the administrative law judge for further proceedings consistent with this order.

By the Commission.

Brent J. Fields
Secretary