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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 4582/February 3, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-17674

In the Matter of ALEXANDER KON	ORDER DENYING RESPONDENT'S MOTION FOR A RULING ON THE PLEADINGS

On November 14, 2016, the Securities and Exchange Commission issued an order instituting proceedings (OIP) against Respondent pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934. On January 3, 2017, Respondent submitted a motion for a ruling on the pleadings, pursuant to 17 C.F.R. § 201.250(a). The Division of Enforcement timely filed an opposition, and Respondent timely filed a reply.

Respondent argues that the present OIP must meet the pleading standard of Federal Rule of Civil Procedure 12(b)(6), and that, because it fails to do so, dismissal is appropriate under Rule 250(a). *See* Motion at 4-6, 10. Respondent also argues that the present OIP must meet the heightened pleading standard for fraud claims, namely, the requirement that the pleader "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b); *see* Motion at 6-7.

Rule 250(a) permits any party, within fourteen days after a respondent's answer has been filed, to

> move for a ruling on the pleadings on one or more claims or defenses, asserting that, even accepting all of the non-movant's factual allegations as true and drawing all reasonable inferences in the non-movant's favor, the movant is entitled to a ruling as a matter of law.

17 C.F.R. § 201.250(a). As the Commission noted in its adopting release, the rule is analogous to Federal Rules of Civil Procedure 12(b)(6) and 12(c), which respectively provide for motions to dismiss for failure to state a claim and for judgment on the pleadings. Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50212, 50224 n.110 (July 29, 2016).

A complaint in district court must include "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). The complaint must plead "sufficient factual matter . . . to 'state a claim to relief that is plausible on its face'" and provide "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (construing Rule 8(a)

and quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 570 (2007)). A complaint that does not meet this standard may be dismissed for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6).

Under the Rules of Practice, an OIP must "[c]ontain a short and plain statement of the matters of fact and law to be considered and determined" and "[s]tate the nature of any relief or action sought or taken." 17 C.F.R. § 201.200(b). There is, however, no explicit requirement that an OIP "state a claim" as that term has been interpreted in the Fed. R. Civ. P. 12(b)(6) context, or that it "state with particularity the circumstances constituting fraud" in the Fed. R. Civ. P. 9(b) context. If, taking the allegations as true, there is a legal defect in the Division's case, a dismissal pursuant to Rule 250(a) may be appropriate. If, however, an OIP is merely insufficiently specific, the remedy is a more definite statement pursuant to Rule 220, not dismissal pursuant to Rule 250(a). *See* 17 C.F.R. § 201.220(d). I therefore hold, apparently as a matter of first impression, that *Iqbal*, *Twombly*, and their progeny do not apply to OIPs, and that an OIP need not "state with particularity the circumstances constituting fraud" within the meaning of Fed. R. Civ. P. 9(b).

As for the merits, Securities Act Section 17(b) prohibits communications in interstate commerce that describe securities for consideration received, directly or indirectly, from an issuer, dealer, or underwriter "without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof." 15 U.S.C. § 77q(b). The OIP alleges that Respondent received $25,000 from an issuer's former CEO as consideration for touting the issuer's stock in a website-based marketing campaign in April 2014. *See* OIP at 2. The OIP further alleges that Respondent's website touts included a disclaimer falsely stating that Respondent received money from the former CEO's son, "third party Casey Cummings," rather than from the issuer or its former CEO. *See id.* According to the OIP, Respondent's actions thereby violated Securities Act Section 17(b). *See id.*

Respondent argues that the misconduct alleged in the OIP did not amount to a violation of the law because the websites at issue disclosed the fact and amount of consideration received. *See* Motion at 7-10. Respondent contends that Section 17(b) does not require disclosure of the source of the consideration, and that "misidentifying the source of the consideration" does not violate Section 17(b). Motion at 8.

A reading of the statutory text alone is sufficient to reject this contention. Section 17(b) contains two elements directly relevant here: (1) the consideration at issue must be "fully disclos[ed]"; and (2) the duty to disclose only arises when the consideration is from an issuer, dealer, or underwriter. 15 U.S.C. § 77q(b). Full disclosure means exactly that – disclosure that is fulsome rather than incomplete. If consideration is received from an issuer, but the only disclosed consideration is gratuitously (or misleadingly) reported to be from a third party, then the consideration from the issuer is not "fully disclos[ed]" within the meaning of Section 17(b). Such a disclosure constitutes an omission, not merely a misidentification of the source of the consideration. Here, drawing all reasonable inferences in the Division's favor, Respondent allegedly omitted disclosure of consideration received from the issuer (via its CEO), and thereby failed to fully disclose that consideration under Section 17(b).

In urging a different result, Respondent cites *SEC v. Recycle Tech, Inc.*, No. 12-21656-CV-LENARD, 2013 WL 12063952 (S.D. Fla. Sept. 26, 2013). *See* Motion at 10. In *Recycle Tech*, two defendants were charged with violating Section 17(b) based on disclaimers stating that they had "received from a third party non affiliate 2.325 million free trading shares of [Recycle Tech] for advertising and marketing," or similar language. 2013 WL 12063952, at *8. According to the complaint, however, both defendants had received their shares indirectly from Recycle Tech, the issuer. *See id*. The district court held that "misidentifying the source of the consideration" did not violate Section 17(b) because the disclaimers "'fully disclos[ed] the receipt . . . of such consideration and the amount thereof.'" *Id*.

According to Respondent, the district court's holding "clearly demonstrate[s] that the Respondent's alleged actions are not in violation of Section 17(b)." Motion at 10. I respectfully disagree with the district court's construction of Section 17(b), because that construction did not consider the entirety of the statutory text. The other cases upon which Respondent relies are either factually distinguishable or do not support his position. *See* Motion at 8-9; Reply at 13.

Respondent's other points are unavailing. Whether Respondent's omission constituted fraud may be relevant to any determination of whether sanctions are in the public interest, but it is not relevant to determining liability under Section 17(b). *See* Reply at 7. I have not considered Respondent's argument that the disclosure requirement constitutes an improper content-based regulation in contravention of the First Amendment, because it was presented for the first time in his reply. *See* Reply at 10-12.

Lastly, Respondent suggests, also for the first time in his reply, that his disclosure was proper because Cummings qualified as an issuer, underwriter, or dealer. *See* Reply at 13-14. But for purposes of the present motion I must draw all reasonable inferences in the Division's favor; as applicable here, that means I must assume that Cummings was a "third party," not an issuer, underwriter, or dealer. OIP at 2; 17 C.F.R. § 201.250(a). And although I may consider matters subject to official notice in resolving a motion brought pursuant to Rule 250(a), the settled administrative proceeding on which Respondent relies is insufficient to demonstrate that Cummings was an issuer, underwriter, or dealer. *See* Reply at 7 n.2 (citing *Casey Cummings*, Securities Act Release No. 10253, 2016 SEC LEXIS 4224 (Nov. 14, 2016)); *Adrian D. Beamish, CPA*, Admin. Proc. Rulings Release No. 4504, 2017 SEC LEXIS 47, at *3 (Jan. 6, 2017) (matters subject to official notice, among other things, may be considered in ruling on a Rule 250(a) motion).

Respondent's motion for a ruling on the pleadings is therefore DENIED.

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Cameron Elliot
Administrative Law Judge