INITIAL DECISION RELEASE NO. 1004
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16795

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

In the Matter of JOSEPH J. FOX	INITIAL DECISION April 25, 2016

APPEARANCES: Anne C. McKinley and Jedediah B. Forkner, for the Division of Enforcement, Securities and Exchange Commission

Joseph J. Fox, pro se

BEFORE: Cameron Elliot, Administrative Law Judge

Summary

Respondent Joseph J. Fox consented to the entry of an order issued by the Securities and Exchange Commission finding that he willfully violated Section 5(a) and (c) of the Securities Act of 1933, and he was ordered to cease and desist from committing such violations and to pay disgorgement and civil penalties. This proceeding was then held to determine what, if any, additional non-financial remedial sanctions under Section 15(b)(6) of the Securities Exchange Act of 1934 are in the public interest. In this initial decision, I grant the Division of Enforcement's motion for summary disposition and find that it is in the public interest that Fox be barred for five years from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from participating in an offering of penny stock.

Procedural Background

On September 8, 2015, the Commission issued an order instituting administrative and cease-and-desist proceedings (OIP) against Fox, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act. The OIP alleges that Fox violated Section 5(a) and (c) of the Securities Act by selling shares of Ditto Holdings, Inc., of which he was CEO, without either registering the shares or meeting the requirements for an exemption from registration. OIP at 2, 4-5. The OIP followed Fox's submission, and the Commission's acceptance, of an offer of settlement, pursuant to which Fox was ordered to pay monetary sanctions and cease and desist from violations of Securities Act Section 5(a) and (c). *Id.* at 1, 5. Fox agreed that, solely for purposes of determining additional non-financial sanctions, the allegations of the OIP "shall be

accepted as and deemed true by the hearing officer." *Id.* at 6-7. The OIP provides that the issues raised in this proceeding may be determined "on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence." *Id.* at 7.

On November 6, 2015, the Division filed a motion for summary disposition, to which were attached a declaration and two exhibits. On January 12, 2016, Fox filed an opposition to the motion, accompanied by seven exhibits, and on January 15, the Division filed a reply. After reviewing the parties' papers, I determined that my evaluation of the public interest factors outlined in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981), would be aided by additional information regarding Fox's scienter, if any. *Joseph J. Fox*, Admin. Proc. Rulings Release No. 3514, 2016 SEC LEXIS 171 (ALJ Jan. 15, 2016). The Division filed a supplemental brief addressing the issue of scienter on February 4, and Fox filed a reply with three exhibits on February 26, 2016.

Legal Standard

A motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). In accordance with the OIP's instructions, I accept and deem true the factual allegations in the OIP. OIP at 6-7. I have also considered stipulations and admissions made by Fox, uncontested affidavits, and facts officially noticed pursuant to 17 C.F.R. § 201.323. *See* 17 C.F.R. § 201.250(a). The filings, documents, and exhibits of record have been fully reviewed and carefully considered. Preponderance of the evidence has been applied as the standard of proof. *See Steadman*, 450 U.S. at 101-04. All arguments and proposed findings and conclusions that are inconsistent with this initial decision have been considered and rejected.

Findings of Fact

Fox, age 49 at the time the OIP was issued, is a resident of Los Angeles, California. OIP at 2. He is the CEO of Ditto Holdings, Inc., a Delaware corporation which previously maintained offices in Los Angeles and Chicago. *Id.*; Prehearing Tr. 17. Ditto Holdings owns 100% of Ditto Trade, Inc., an Illinois corporation headquartered in Chicago. OIP at 2. Ditto Trade was a registered broker-dealer from July 2010 to December 18, 2015, when it withdrew its registration. *Id.*; Ditto Trade, Inc. Broker Check report at 2.[1] Fox was CEO of Ditto Trade from its inception until December 2014. OIP at 2. He was also a registered representative with Ditto Trade from 2010 to December 2014, when he voluntarily withdrew his broker's license. *Id.* While Fox has held Series 7, 24, 27, 28, and 63 licenses at various points in his career, he currently has no active licenses. Prehearing Tr. 21-22, 32; Joseph J. Fox Broker Check report at 3. Ditto Holdings is no longer operating and has several judgments from creditors outstanding against it. Prehearing Tr. 17, 32.

From April 2009 to September 2013, Ditto Holdings raised approximately $10 million from more than two hundred U.S. investors through a series of common and preferred stock

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[1] Official notice of this report and of Fox's Broker Check report is taken pursuant to 17 C.F.R. § 201.323.

offerings. OIP at 2. Fox played an integral role in these capital-raising efforts, helping determine the timing and terms of the offerings, the types of securities offered, and the manner in which the offerings were communicated to potential investors. *Id.* The purchasers of Ditto Holdings stock ultimately included both accredited and non-accredited investors. *Id.* at 2-3. Accordingly, in order for the offerings to qualify for an exemption to registration under Rule 506 of Regulation D, the exemption Fox attempted to utilize, all of the non-accredited investors should have received certain financial statements and information regarding Ditto Holdings. *See* 17 C.F.R. §§ 230.502(b), .506(b); *see, e.g.,* Form D filed by Ditto Holdings on June 27, 2013.[2] But Ditto Holdings did not maintain a complete and accurate set of financial records, did not regularly prepare financial statements, and was never audited during the period at issue. OIP at 3. Although some investors received financial information regarding Ditto Trade, no investor received the audited financial statements and other information required under Rule 506 relating to Ditto Holdings. *Id.* & n.3.

In order to reach more potential investors, Ditto Holdings entered into a series of agreements with Marc Mandel pursuant to which Mandel provided marketing advice and other services to Ditto Holdings. *Id.* Mandel hosted a radio program on which Ditto Trade advertised, and he distributed an investing newsletter introducing his roughly 350 subscribers to Ditto Holdings' securities offerings and to Ditto Trade's features and services. *Id.* Subscribers also received numerous emails from Mandel regarding Ditto Holdings, and Mandel hosted a series of online webinars and in-person meetings for investors with Fox. *Id.* More than seventy of Mandel's subscribers ultimately purchased securities from Ditto Holdings, amounting to $3.7 million of the $10 million total raised by Ditto Holdings. *Id.* at 2-3.

Between April 2013 and July 2013, Fox sold some of his own Ditto Holdings shares to investors. *Id.* at 4. He did so with the help of Mandel, who again emailed his newsletter subscribers praising Ditto Holdings and telling them about the opportunity to buy shares of Ditto Holdings stock. *Id.* When individuals expressed interest, Mandel gave them a copy of a stock purchase agreement provided to him by Fox, and told them to contact Fox if they needed more information. *Id.* Fox told Mandel that the stock purchase agreement was the only document interested purchasers would need to complete. *Id.* Neither Fox nor anyone acting on his behalf took any steps to determine whether the purchasers were sophisticated investors, despite the fact that at least two had previously identified themselves to Ditto Holdings as non-accredited investors. *Id.* Twenty-eight of Mandel's subscribers purchased a total of $1.25 million of Fox's common stock, but none of the investors had access to financial statements or other required information about Ditto Holdings. *Id.*

No registration statements were filed in connection with any of Ditto Holdings' securities, and exemptions from registration were not available for all of the transactions described above. *Id.* at 4. As a result, the OIP found that Fox willfully violated Section 5(a) and (c) of the Securities Act, which prohibit the direct or indirect offer and sale of securities through the mails or interstate commerce unless a registration statement has been filed or is in effect or an exemption from registration is available. *Id.* at 5; *see* 15 U.S.C. § 77e(a), (c).

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[2] Pursuant to 17 C.F.R. § 201.323, I take official notice of this document and of Ditto Holdings' and Ditto Trade's other filings on the Commission's EDGAR database.

Conclusions of Law

The Division seeks to bar Fox from the securities industry[3] pursuant to Exchange Act Section 15(b)(6), with the right to apply for reentry after five years. Div. Mot. at 4, 12. Section 15(b)(6) authorizes the Commission to censure, limit the activities of, suspend, or bar Fox from the industry if the following criteria are met: (1) at the time of the alleged misconduct, Fox was associated or seeking to become associated with a broker or dealer; (2) Fox has willfully violated any provision of the Securities Act or its rules or regulations; and (3) the sanction imposed is in the public interest. 15 U.S.C. §78*o*(b)(4)(D), (6)(A)(i). The first requirement is met because during the majority of the time he engaged in his misconduct, Fox was the CEO and a registered representative of Ditto Trade, a registered broker-dealer. OIP at 2. Because Fox consented to an order finding that he willfully violated Section 5(a) and (c) of the Securities Act, the second requirement is also met. *Id.* at 1, 5. Accordingly, I will impose a sanction if it is in the public interest.

A. The Public Interest Factors

The criteria to determine whether a sanction is in the public interest are the *Steadman* factors: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140; *see Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010). The Commission also considers the age of the violation, the degree of harm to investors and the marketplace resulting from the violation, and the deterrent effect of administrative sanctions. *See Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35 & n.46 (Jan. 31, 2006); *Marshall E. Melton*, Exchange Act Release No. 48228, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003). The Commission's inquiry into the appropriate sanction to protect the public interest is flexible, and no one factor is dispositive. *Gary M. Kornman*, 2009 SEC LEXIS 367, at *22. In deciding whether the public interest warrants an industry bar, I must determine that "such a remedy is necessary or appropriate to protect investors and markets." *Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416, at *2 (Mar. 7, 2014).

Fox's conduct was egregious. "The registration requirements [of Securities Act Section 5] are the heart of the securities regulatory system." *Charles F. Kirby*, 56 S.E.C. 44, 49 (2003). Fox circumvented these critical requirements by selling unregistered securities to dozens of non-accredited investors without providing them required financial information on Ditto Holdings. OIP at 2-4. As a result, both investors and the marketplace were harmed by being deprived of information necessary to make fully informed investment decisions. *See Gordon Brent Pierce*,

[3] The bar sought by the Division is a bar from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from participating in an offering of penny stock. Div. Mot. at 4, 12; *see* 15 U.S.C. §78*o*(b)(6).

Securities Act Release No. 9555, 2014 SEC LEXIS 839, at *84 (Mar. 7, 2014). It also appears that Ditto Holdings' investors suffered financial losses. Though Fox claims that "[n]o shareholders were harmed, intentionally or otherwise," he has also represented that "our shareholders, and myself, my family, and my mother, we lost our entire investment." Resp. Opp. at 11; Prehearing Tr. 17.

I reject Fox's suggestion that his violations were not egregious because Ditto Trade, alleged to be Ditto Holdings' sole operating subsidiary, had its financial statements audited annually. Resp. Opp. at 11. Investors purchased shares of Ditto Holdings, not of Ditto Trade. The fact that some investors received information about Ditto Trade's finances does not cure the harm inflicted by Fox's failure to properly disclose Ditto Holdings' financial information. *See* OIP at 3 n.3. Fox also fails to explain why his unsupported allegation that "[m]ost of the investors in [Ditto Holdings] were unsolicited" mitigates the egregiousness of his actions. Resp. Opp. at 11. Finally, Section 5 violations are not merely "technical" in nature, as Fox contends. Div. Mot. Ex. A at 2; Resp. Opp. at 5; *mPhase Techs., Inc.*, Exchange Act Release No. 74187, 2015 SEC LEXIS 398, at *24 n.41 (Feb. 2, 2015) ("The importance of [Section 5's registration] provisions undermines [Respondent]'s attempt to characterize [its] violations as merely 'technical' in nature." (citing *Owen V. Kane*, 48 S.E.C. 617, 623 (1986))).

Fox's violations were recurrent, involving at least three different offerings and the sale of Fox's own stock, over the course of almost four and a half years. OIP at 2-4. They concluded fewer than three years ago; although not especially recent, they also were not especially remote. *Id.* at 2.

The evidence is mixed regarding the sincerity of Fox's assurances against future violations and his recognition of the wrongful nature of his conduct. Fox asserts that Ditto Holdings was audited after he learned of the financial disclosure requirements, and he claims to have directed a "self-imposed freeze on new capital raising until the audit of the holding company could be completed." Resp. Opp. at 12. This suggests that Fox recognized his misconduct and attempted to avoid it in the future. His settlement with the Commission, though done on a neither-admit-nor-deny basis, also suggests a recognition of his misconduct. On the other hand, in an email sent to Ditto Holdings investors shortly after the issuance of the OIP, Fox described himself as being "vindicated," and characterized his settlement with the Commission as the "SEC back[ing] into what we consider inadvertent technical rules violations." Div. Mot. Ex. A at 1-2. He also noted that the "[OIP] is clear that we are not admitting or denying the findings in the order" and indicated that he only settled with the Commission so as "to not drag out [his] negotiations for the betterment of [Ditto Holdings]." *Id.* at 2. Fox insists that his use of the word "technical" was not intended to minimize the severity of his violations. Resp. Opp. at 5-6. But when read as a whole, the email is an obvious attempt to downplay and excuse his misconduct – Fox even asks the recipients to consider additional investments in Ditto Holdings now that "the SEC issue [is] behind us." Div. Mot. Ex. A at 2-3. This calls into question the degree to which he acknowledges his misconduct and the sincerity of his assurances against future wrongdoing.

Ditto Holdings and Ditto Trade are no longer operational. Ditto Trade, Inc. Broker Check report at 2; Prehearing Tr. 16-17, 32. Fox does not hold any active securities licenses, and

he has no definite plans to participate in the securities industry in any capacity in the future. Resp. Opp. at 13; Resp. Supp. Reply at 2; Prehearing Tr. 20-23, 31-33. Accordingly, although his occupation presents opportunities for future violations, it is uncertain whether he will continue in that occupation, and this factor does not weigh heavily in favor of a severe sanction.

B. Scienter

There is no evidence that Fox intentionally violated Section 5, and Fox vigorously disputes that he did so. *See* Resp. Opp. at 1, 12-13. The Division instead argues that "there is ample evidence to demonstrate that Fox acted *at least recklessly* in violating the securities registration provisions," pointing to two pieces of evidence – the fact that Fox was "an experienced securities professional" and, relatedly, the various FINRA licenses held by Fox at different times in his career. Div. Supp. Br. at 2-3 (emphasis added). "In light of his credentials and experience," the Division insists that "Fox must have known the basic requirements for complying with the securities registration provisions and foreseen the risk of violating those provisions by selling securities to non-accredited investors." *Id.* at 3.

The Division has demonstrated that Fox acted at least recklessly. "Securities professionals are required to be knowledgeable about, and to comply with, the regulatory requirements to which they are subject." *Abraham and Sons Capital, Inc.*, 55 S.E.C. 252, 268 (2001). Failure to meet this standard constitutes an "'extreme departure from the standards of ordinary care . . .' and establishes recklessness." *Id*. at 268-69 (alteration in original) (quoting *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992)). I am not persuaded by any of Fox's arguments on this point.

Fox argues that he confused Rule 504 of Regulation D, which does not require financial information to be disclosed to unaccredited investors, with Rule 506, which does contain such a requirement. Resp. Supp. Reply at 3; 17 C.F.R. §§ 230.502(b), .504(b), .506(b). He maintains that none of his FINRA license exams or study materials went into detail on the disclosure requirement differences between Rule 504 and Rule 506 offerings, and he claims that he provided similar financial disclosures in a previous securities offering without any complaint from the Commission. Resp. Opp. at 2, 6-7; Resp. Supp. Reply at 3. I agree that the Series 7 and 24 exam outlines highlighted by the Division do not establish that the financial disclosure requirements of Regulation D offerings were covered in detail by either exam. *See* Div. Supp. Br. at 2; Resp. Supp. Reply at 3. But that does not absolve Fox of responsibility for selling securities using an exemption to registration that he failed to adequately understand. His claim that he mistakenly applied Rule 504's disclosure requirements to his (attempted) Rule 506 offerings hurts rather than helps his case. Rule 504 is limited, as stated in the title of the rule, to "offerings and sales of securities not exceeding $1,000,000." 17 C.F.R. § 230.504. Fox evidently ascertained that this exemption was not available for Ditto Holdings' stock offerings, each of which exceeded $1,000,000. OIP at 2-3. Yet Fox suggests that after correctly selecting Rule 506 as a potentially available exemption, he was unable to understand the differences between the two rules because Regulation D is difficult for "most, if not all laypersons" to understand. Resp. Supp. Reply at 3. Even if true, it was unreasonable for him to assume that Rules 504 and 506 – which, among other distinctions, are strikingly different in scope – would contain the same financial disclosure requirements.

Fox has also failed to establish that he reasonably relied on prior dealings with the Commission when making the assumption that Rules 504 and 506 contained similar disclosure requirements. He describes a series of private offerings and sales and an initial public offering undertaken by him and his brother in the late 1990s, and asserts that the Commission did not have "any issues with our level of financial disclosures to non-accredited investors." Resp. Opp. at 7. Even if true, it was not reasonable to construe the Commission's silence or inaction as approval. *Cf. S.W. Hatfield, C.P.A.*, Exchange Act Release No. 69930, 2013 SEC LEXIS 1954, at *16-17 (July 3, 2013) ("[T]he supposed silence or inaction of Commission staff in its reviews of [previously filed] registration statements may not be construed as Commission approval of those companies' practices[.]").

Fox's claim that he relied on advice of outside counsel when selling his personal shares of Ditto Holdings stock does not alter my conclusion on scienter. Resp. Opp. at 11. While reliance on counsel is not a defense to a charge of violating Section 5, it "may be considered as a mitigating factor in determining what sanction is required in the public interest." *D.F. Bernheimer & Co., Inc.*, 41 S.E.C. 358, 364 n.7 (1963); *see Rodney R. Schoemann*, Securities Act Release No. 9076, 2009 SEC LEXIS 3939, at *45 (Oct. 23, 2009) (advice-of-counsel is not a defense to a Section 5 charge), *aff'd*, 398 F. App'x 603 (D.C. Cir. 2010). But Fox's reliance defense relates only to the sale of his personal stock and does nothing to lessen his recklessness with respect to Ditto Holdings' stock offerings; Ditto Holdings' purported inability to afford an outside securities attorney to advise on the offerings is no excuse. Resp. Opp. at 2, 10. Fox also undermines the defense by asserting that he "mistakenly believed that all of the individuals that purchased [his] shares were accredited," suggesting he also mistakenly failed to make a complete disclosure to his counsel regarding the facts surrounding the sale. Resp. Opp. at 12; *see Rodney R. Schoemann*, 2009 SEC LEXIS 3939, at *46 (advice-of-counsel defense requires a "complete disclosure to counsel" of the intended conduct).

C. A Bar is in the Public Interest

On the one hand, Fox has made some assurances against future violations, there is little concrete evidence of investor losses, his violations were not particularly recent, and Fox's professional future remains uncertain. On the other hand, he acted with some degree of scienter, his recognition of the wrongful nature of his misconduct is dubious, and his violations were egregious and recurrent. I find particularly significant Fox's admitted confusion regarding Rules 504 and 506, which suggests a lack of current competence and a substantial degree of risk to investors and securities markets posed by his continuance in the securities industry. *See Gregory Bartko*, Exchange Act Release No. 71666, 2014 SEC LEXIS 841, at *34 (Mar. 7, 2014). A five-year bar is appropriate in the public interest.

Order

Accordingly, it is ORDERED that the Division's motion for summary disposition against Joseph J. Fox is GRANTED, and that pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Joseph J. Fox is BARRED for a period of five years from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or

nationally recognized statistical rating organization, and from participating in an offering of penny stock, including acting as any promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

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

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Cameron Elliot
Administrative Law Judge