INITIAL DECISION RELEASE NO. 993
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16943

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

In the Matter of	:	INITIAL DECISION
	:	April 4, 2016
LONNY S. BERNATH	:	

APPEARANCES: Joshua A. Mayes, for the Division of Enforcement, Securities and Exchange Commission

Robert J. Mottern, Esq., Davis Gillett Mottern & Sims, LLC, for Respondent

BEFORE: Jason S. Patil, Administrative Law Judge

Summary

This initial decision grants the Division of Enforcement's motion for summary disposition and permanently bars Respondent Lonny S. Bernath from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (collectively, associational bar).

Procedural Background

On November 5, 2015, the Securities and Exchange Commission issued an order instituting proceedings (OIP) against Bernath pursuant to Section 203(f) of the Investment Advisers Act of 1940. Bernath was served with the OIP on November 17, 2015, and he filed his answer on December 10, 2015.

Based on the parties' agreement that the matter be decided by briefing with no evidentiary hearing, I granted the Division leave to file a motion for summary disposition. *See Lonny S. Bernath*, Admin. Proc. Rulings Release No. 3423, 2015 SEC LEXIS 5183 (ALJ Dec. 21, 2015).

On January 19, 2016, the Division filed its motion for summary disposition (Div. Mot.), along with three exhibits (Div. Exs. 1-3).[1] On February 10, 2016, Bernath filed his opposition to the Division's motion (Resp. Opp.), with no supporting exhibits. On February 18, 2016, the Division submitted its reply (Div. Reply).

Arguments of the Parties

The OIP alleges that Bernath was enjoined from violations of certain securities laws in the civil action *SEC v. Bernath*, No. 3:15-CV-485 (W.D.N.C.) (*SEC v. Bernath*). OIP ¶ 2. Based on the injunction and the conduct underlying it, the Division seeks a full associational bar against Bernath. Div. Mot. at 1, 8.

In his answer and opposition to the Division's motion, Bernath states that he does not contest the entry of a bar, but requests that the bar be limited to five years, or, alternatively, that the bar not have the collateral consequence of prohibiting reliance on Rule 506 of Regulation D, 17 C.F.R. § 230.506, by an entity he is associated with in the future, unless the entity is of a type specifically listed in Section 203(f) of the Advisers Act.[2] Answer ¶¶ 5, 6; Resp. Opp. ¶¶ 1, 10. Bernath expects to have future employment opportunities with firms raising capital pursuant to Rule 506, and argues that "it is manifestly unfair, not in the public interest, and unnecessary to prohibit him or any company with which he is associated from utilizing Rule 506 to offer securities in private placements if the issuer is not one of the entities specifically mentioned in Section 203(f)." Resp. Opp. ¶¶ 6-7. Specifically, Bernath takes issue with the fact that because this case arises under Advisers Act Section 203(f), the collateral disqualification would be permanent; he argues that "misconduct much more severe than that which warrants relief under Section 203(f) is subject to time limits rather than being a lifetime ban." *Id*. ¶¶ 8-9. In its reply, the Division argues that the public interest factors weigh in favor of permanently barring Bernath from associating with securities industry participants and against any limitation on the collateral disqualification that would follow from such a bar. Div. Reply at 2-4.

Summary Disposition 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). The facts of the pleadings of the party against whom the motion is made shall be taken as true, except as modified by stipulations or admissions made by him, uncontested affidavits, or facts officially noticed pursuant to Rule of Practice 323. 17 C.F.R. § 201.250(a).

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[1] Exhibits 1, 2, and 3 are, respectively, the Division's complaint, Bernath's consent to the entry of judgment, and the court's judgment in the underlying federal district court case.

[2] Rule 506 exempts securities offerings from registration if certain conditions are met. These exempt offerings are usually called private placements. No exemption is available under Rule 506 if, among other "bad actor" disqualifications, an officer or managing member of the issuer is subject to a bar under Advisers Act Section 203(f). 17 C.F.R. § 230.506(d)(1)(iv).

The Commission has repeatedly upheld the use of summary disposition in cases such as this, where the respondent has been enjoined or convicted and the sole determination concerns the appropriate sanction. *See Gary M. Kornman*, Securities Exchange Act of 1934 Release No. 59403, 2009 SEC LEXIS 367, at *40-41 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010); *Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 SEC LEXIS 236, at *19-20 & nn.21-24 (Feb. 4, 2008) (collecting cases), *pet. denied*, 561 F.3d 548 (6th Cir. 2009). "A consent injunction . . . 'may furnish the sole basis for remedial action . . . if such action is in the public interest.'" *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *8 (July 25, 2003) (quoting *Cortlandt Investing Corp*., Exchange Act Release No. 8678, 1969 SEC LEXIS 273, at *19 (Aug. 29, 1969)). Under Commission precedent, the circumstances in which summary disposition in a follow-on proceeding involving fraud is not appropriate "will be rare." *John S. Brownson*, Exchange Act Release No. 46161, 2002 SEC LEXIS 3414, at *9 n.12 (July 3, 2002), *pet. denied*, 66 F. App'x 687 (9th Cir. 2003).

The findings and conclusions in this initial decision are based on the record and on facts officially noticed pursuant to Rule of Practice 323, including the Commission's official public records. *See* 17 C.F.R. § 201.323. Preponderance of the evidence has been applied as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 101-04 (1981). The parties' filings and all documents and exhibits of record have been fully reviewed and carefully considered. All arguments and proposed findings and conclusions that are inconsistent with this initial decision have been considered and rejected.

Findings of Fact

Bernath, age 43 at the time this proceeding was instituted, is an MIT-educated mathematician and engineer. OIP ¶ 1; Answer ¶ 1; Resp. Opp. ¶ 7. Bernath was registered as an investment adviser representative in Massachusetts from 2003 to 2006. OIP ¶ 1; Answer ¶ 1. From 2003 to 2014, utilizing successive corporate forms collectively referred to as "Headline Management," Bernath owned and operated an investment adviser firm registered at different times with the states of Massachusetts and North Carolina. OIP ¶ 1; Answer ¶ 1. Bernath, through Headline Management, made investment decisions for several private investment funds, including Headline Group, LP, Headline Partners, LP, and Dynasty Capital Partners, LP (the Funds), and was responsible for communications to investors and potential investors in the Funds. OIP ¶ 1; Answer ¶ 1; Div. Ex. 1 ¶¶ 1, 2.[3]

Between at least 2007 and 2011, Bernath, without disclosing the transactions or conflicts of interest, directed the Funds to: (a) give loans to and make investments in three real estate limited partnerships that Bernath managed and in which he held a financial interest; (b) make investments in an automotive chrome plating facility in which Bernath held a financial interest; and (c) transfer investments and loans among themselves to meet liquidity needs of each fund. OIP ¶ 3; Answer ¶ 1; Div. Ex. 1 ¶ 1. Furthermore, between at least 2009 and 2011, Bernath misrepresented the investment activities of the Funds to investors. OIP ¶ 3; Answer ¶ 1; Div. Ex. 1 ¶ 1. Moreover, from 2008 until 2011, Bernath periodically wrote down the value of the Funds'

[3] As explained below, per his consent judgment, Bernath may not contest any factual allegations outlined in the complaint in *SEC v. Bernath*. Div. Ex. 2 ¶ 11.

investments in these affiliated entities, to the detriment of the Funds' investors and without their knowledge. OIP ¶ 3; Answer ¶ 1; Div. Ex. 1 ¶ 31. Bernath did not disclose the Funds' transactions with related entities until 2013. Div. Ex. 1 ¶ 32. As of July 2015, Bernath no longer manages Headline Management, the Funds, or the real estate partnerships. OIP ¶ 1; Answer ¶ 1; Div. Ex. 1 ¶ 2.

On October 13, 2015, the Division filed a complaint and unopposed motion for entry of judgment against Bernath in the civil action *SEC v. Bernath*. *SEC v. Bernath*, ECF Nos. 1-2; Div. Ex. 1. The unopposed motion for entry of judgment included as an exhibit a consent to judgment signed by Bernath on September 16, 2015. *SEC v. Bernath*, ECF No. 2-2; Div. Ex. 2. In the consent to judgment, Bernath stated that he understood, among other things, that: (1) the court's entry of a permanent injunction may have collateral consequences under federal or state laws; and (2) "in any disciplinary proceeding before the Commission based on the entry of the injunction in this action, [Bernath] understands that he shall not be permitted to contest the factual allegations of the complaint in this action." *Id*. On October 30, 2015, a judgment was entered by consent against Bernath, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, 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 Advisers Act and Rule 206(4)-8 thereunder. *SEC v. Bernath*, ECF No. 3; OIP ¶ 2; Answer ¶ 1; Div. Ex. 3.

Conclusions of Law

Advisers Act Section 203(f) authorizes imposition of an industry bar against Bernath if: (1) at the time of the alleged misconduct, he was associated with an investment adviser; (2) he has been enjoined from any action, conduct, or practice specified in Advisers Act Section 203(e)(4); and (3) the sanction is in the public interest. 15 U.S.C. § 80b-3(f). Bernath owned and controlled a state-registered investment-adviser firm, and thus was associated with an investment adviser within the meaning of Advisers Act Section 203(f) at the time of the misconduct. The injunction imposed on Bernath in the civil case is an injunction within the meaning of Advisers Act Section 203(e)(4), because it enjoined Bernath in connection with the purchase or sale of any security. 15 U.S.C. § 80b-3(e)(4), (f). Accordingly, a bar will be imposed if it is in the public interest.

Sanctions

The appropriateness of any remedial sanction in this proceeding is guided by the *Steadman* factors: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *see Gary M. Kornman*, 2009 SEC LEXIS 367, at *22. 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. 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 *35-36 (Jan. 31, 2006); *Marshall E. Melton*, 2003 SEC LEXIS 1767, at *4-5.

The public interest factors weigh in favor of barring Bernath from participation in the securities industry to the fullest extent possible. *See Ross Mandell*, Exchange Act Release No. 71668, 2014 SEC LEXIS 849, at *7-8 (Mar. 7, 2014).

1. The egregious and recurrent nature of Bernath's misconduct

Bernath's actions were egregious and recurrent. Bernath, among other things: failed to disclose to investors that he caused the Funds to invest in entities in which he held a financial interest, misrepresented the investment activities of the Funds to investors, and periodically wrote down the value of the Funds' investments in these entities, to the detriment of the Funds' investors and without their knowledge. This misconduct occurred over the course of several years, and Bernath did not disclose the Funds' transactions with related entities until 2013, relatively recently. As established by the district court complaint, the allegations of which Bernath cannot now contest in light of his consent judgment, he violated the antifraud provisions of the federal securities laws. The Commission considers conduct involving fraud to be particularly serious and subject to severe sanctions. *See, e.g., Peter Siris*, Exchange Act Release No. 71068, 2013 SEC LEXIS 3924, at *23 (Dec. 12, 2013), *pet. denied*, 773 F.3d 89 (D.C. Cir. 2014).

2. Scienter

Bernath, an educated mathematician and engineer, acted with scienter. He was at all times fully aware that he was perpetuating a fraudulent and deceptive scheme that would benefit him financially, which he achieved through misrepresentations to his investment clients.

3. Assurances against future violations and recognition of the wrongful nature of his conduct

While I take into account that Bernath cooperated in the civil case and consented to the judgment, there is no reliable assurance against future violations by Bernath. Although "[c]ourts have held the existence of a past violation, without more, is not a sufficient basis for imposing a bar[,] . . . 'the existence of a violation raises an inference that it will be repeated.'" *Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 SEC LEXIS 2155, at *23 n.50 (July 26, 2013) (quoting *Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004)) (alteration in internal quotation omitted). Bernath has failed to present any evidence to rebut that inference.

4. Opportunities for future violations

Given his young age and educational background, Bernath will have significant opportunities for future violations. Indeed, Bernath has acknowledged his expectation for future employment opportunities as an officer of an issuer utilizing Rule 506 to raise capital in private placements. Resp. Opp. ¶¶ 2-3, 7. Without the imposition of a bar, Bernath would be able to

continue to work in in the securities industry—likely in prominent positions that could put investors at risk—and would thus have opportunities to commit further violations over the years.

5. Other considerations

Bernath's misconduct harmed investors, who were unaware that Bernath had multiple conflicts of interest in the Funds' transactions. There is also harm to the marketplace, given that efficient and honest markets require full and accurate information be provided to investors. *See Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988). I also find that an associational bar will provide effective deterrence. *See Guy P. Riordan*, Exchange Act Release No. 61153, 2009 SEC LEXIS 4166, at *81 & n.107 (Dec. 11, 2009) (collecting cases), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010).

The foregoing factors support the imposition of a permanent associational bar against Bernath. In addition, Bernath has failed to demonstrate how relieving him from the automatic Rule 506 collateral consequences of a bar would be in the public interest. *Cf.* 17 C.F.R. § 230.506(d)(2)(iii) (providing that the Commission, in its relevant order barring a respondent, may advise in writing that disqualification should not arise as a consequence of such order). Bernath has not claimed his conduct was not egregious, but instead focuses on the expectation that he will have future employment opportunities with firms raising capital pursuant to Rule 506, and that different triggering events result in temporary Rule 506 bans under Regulation D. Bernath's future employment prospects are not a reason to relieve him of the automatic collateral consequences flowing from his egregious conduct. Given the "danger of fraud in private placements," 156 Cong. Rec. S3813 (May 17, 2010) (statement of Sen. Dodd), the need to disqualify persons such as Bernath from engaging in exempt offerings under Rule 506 is apparent. The fact that different triggering events warrant temporary as opposed to permanent Rule 506 bans under Regulation D is also unpersuasive, as Bernath has not shown that his case is unique, such that the usual collateral consequences of a Section 203(f) bar should not apply to him. Therefore, I decline to relieve Bernath from such collateral consequences of the bar.

Under Rule 506, the triggering event for the bad actor disqualification is, as relevant here, a Commission order imposing a Section 203(f) bar issued after September 23, 2013. 17 C.F.R. § 230.506(d)(1)(iv), (d)(2)(i). The Commission adopted this effective date in response to retroactivity concerns raised during the rulemaking process, noting that "[a] triggering event [(e.g., a criminal conviction or court or regulatory order)] that occurs after effectiveness of the rule amendments will result in disqualification, even if the underlying conduct occurred before effectiveness." Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, 78 Fed. Reg. 44730, 44749 & n.232 (July 24, 2013). Bernath's misconduct occurred before Rule 506's collateral disqualification was promulgated by the Commission, but he does not argue before me that application of the disqualification to him is impermissibly retroactive. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208-09 (1988) ("[A] statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms."); *see also Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994) ("When . . . the statute contains no such express command [by Congress regarding its temporal reach], the court must determine whether the new statute [or regulation promulgated thereunder] would have retroactive effect,

i.e., whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed."); *Koch v. SEC*, 793 F.3d 147, 157-58 (D.C. Cir. 2015) (holding on retroactivity grounds that the Commission cannot apply Dodd-Frank Act's new collateral bars to a respondent based on conduct predating Dodd-Frank), *cert. denied*, No. 15-781, 2016 WL 1173131 (Mar. 28, 2016). Because I likely lack the authority to decide such issue, as administrative law judges do not sit in judicial review of Commission rules, Bernath cannot be faulted for not raising it. Such issue is better directed to the Commission or a court of appeals.

Order

It is ORDERED that, pursuant to Rule of Practice 250(b), the Division of Enforcement's motion for summary disposition against Respondent Lonny S. Bernath is GRANTED.

It is FURTHER ORDERED that, pursuant to Section 203(f) of the Investment Advisers Act of 1940, Lonny S. Bernath is permanently BARRED from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

This initial decision shall become effective in accordance with and subject to the provisions of Rule of Practice 360. *See* 17 C.F.R. § 201.360. Pursuant to that Rule, 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 Rule of Practice 111. *See* 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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Jason S. Patil
Administrative Law Judge