INITIAL DECISION RELEASE NO. 1140
ADMINISTRATIVE PROCEEDING
FILE NO. 3-17686

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

| In the Matter of<br><br>JAMES Y. LEE | INITIAL DECISION ON DEFAULT<br>May 22, 2017 |
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APPEARANCES: Michael D. Foster and Jennifer Peltz for the Division of Enforcement, Securities and Exchange Commission

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

## BACKGROUND

On November 17, 2016, the Securities and Exchange Commission issued an order instituting proceedings (OIP) against James Y. Lee pursuant to Section 203(f) of the Investment Advisers Act of 1940, which authorizes barring a person from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (collectively, industry bar) under certain conditions if it is in the public interest. The OIP alleges that in July 2016, a final judgment was entered by consent against Lee in *SEC v. Lee*, No. 14-cv-347 (S.D. Cal.) (civil case), enjoining him from future violations of the antifraud provisions of the federal securities laws. OIP at 1. In October 2014, Lee also entered a guilty plea in a parallel criminal proceeding concerning many of the same facts, *United States v. Lee*, No. 14-cr-2937 (S.D. Cal.) (criminal case). The OIP does not refer to the 2014 criminal case. However, it may be considered in assessing whether the public interest supports barring Lee from the securities industry. *See Timbervest, LLC*, Advisers Act Release No. 4197, 2015 SEC LEXIS 3854, at *81 & n.114 (Sept. 17, 2015), *pet. for review filed*, No. 15-1416 (D.C. Cir. Nov. 13, 2015).

Lee is incarcerated at Taft Correctional Institution (Taft CI), where the OIP was sent to him by U.S. Postal Service certified mail and delivered on November 21, 2016. *James Y. Lee*, Admin. Proc. Rulings Release No. 4435, 2016 SEC LEXIS 4577, at *1 (ALJ Dec. 12, 2016). I held a telephonic prehearing conference on December 21, 2016, at which the Division of Enforcement appeared but Lee did not. *James Y. Lee*, Admin. Proc. Rulings Release No. 4488, 2016 SEC LEXIS 4822, at *1 (ALJ Dec. 28, 2016). The day before the conference, a Taft CI staff member informed the Division that Lee had declined to participate in the conference, and that Lee would have attorney John Kirby contact the Division. *Id.* at *1-2. Kirby represented Lee in the civil and criminal cases. During the conference, the Division described its efforts to

communicate with Lee and Kirby, as well as Kirby's representations to the Division that he did not represent Lee in this proceeding. *Id.* at *2; Prehr'g Transcript 4-7. Following the conference, the Division filed a declaration establishing that it had made the investigative file available to Lee for inspection and copying pursuant to 17 C.F.R. § 201.230 and that Kirby was not representing Lee in this proceeding.

Although the OIP was delivered to Taft CI on November 21, 2016, out of an abundance of caution, I deemed the date of service to be December 20, 2016, the date on which the Division received email confirmation from Taft CI that Lee was aware of this proceeding; Lee's answer to the OIP was therefore due January 9, 2017. *James Y. Lee*, 2016 SEC LEXIS 4822, at *1. After Lee failed to file an answer by the due date, I issued an order for Lee to show cause by January 23 why this proceeding should not be determined against him for his failure to answer, appear at the prehearing conference, or otherwise defend the proceeding. *James Y. Lee*, Admin. Proc. Rulings Release No. 4516, 2017 SEC LEXIS 83 (ALJ Jan. 11, 2017).

Lee did not respond to the show cause order. On January 30, 2017, the Division submitted a motion for default and sanctions seeking an industry bar against Lee. The motion includes the declaration of Jennifer Peltz and six exhibits: Ex. A is the Commission's complaint in the civil case; Ex. B is Lee's consent to the final judgment in the civil case, filed on July 13, 2016; Ex. C is the final judgment in the civil case, entered on July 15, 2016; Ex. D is Lee's October 9, 2014, plea agreement in the criminal case; Ex. E is the transcript of Lee's October 9, 2014, change of plea hearing in which Lee pleaded guilty in the criminal case; and Ex. F is the judgment in the criminal case, entered on May 21, 2015.

## FINDINGS OF FACT

Lee is in default because he did not file an answer, participate in the prehearing conference, or otherwise defend the proceeding. 17 C.F.R. §§ 201.155(a), .220(f), .221(f). Pursuant to the Commission's Rules of Practice, I deem the allegations in the OIP to be true. 17 C.F.R. § 201.155(a). The findings and conclusions in this initial decision are based on the record and on facts officially noticed under Rule 323, 17 C.F.R. § 201.323.

### The Criminal Case and Prior Administrative Proceeding

In December 1997, following a jury trial, Lee was convicted of wire fraud and pension embezzlement in *United States v. Lee*, No. 95-cr-41 (N.D. Cal.), and in November 1998 he was sentenced to thirty months in custody, followed by three years of supervised release, and ordered to pay restitution of $2,880,000. Ex. D at 3; Ex. E at 16.

Lee failed to pay the vast majority of the ordered restitution from his 1997 conviction. Ex. E at 16. In the subsequent October 2014 criminal case, he admitted to engaging in fraudulent and deceptive practices to prevent the United States from collecting the outstanding restitution amount, pled guilty to a criminal charge of the obstruction of justice, agreed to forfeit up to $10,635,403.34, and was sentenced to seventy-eight months in prison and three years of

supervised release.[1] Ex. D at 1-2; Ex. E at 9-10, 17-22; Ex. F at 2-3. Lee concealed money that he obtained from clients by:

> soliciting clients to conduct online trading on their behalf in exchange for a share of profits; inducing potential clients to hire him by fraudulently making false representations and promises and omitting material information; instructing clients to send management fees to bank accounts that he opened in the name of shell corporations and using credit cards in the names of others to pay for expenses and bills from his shell corporation accounts. He also sent falsified invoices to clients to ensure that he would continue to fraudulently receive income without the knowledge of the United States.

Ex. E at 17-18; *see* Ex. D at 3-4.

Lee further admitted that, to obstruct justice and hinder efforts of the United States to collect the ordered restitution, he incorporated a San Diego-based shell corporation in April 2007 without any indication that he controlled the corporation, and that between August 2009 and August 2011, he sent invoices to clients on this corporation's letterhead directing payment to its bank account for his management of the clients' online trading accounts. Ex. E at 18-19. In soliciting clients, Lee failed to disclose his 1997 criminal conviction. *Id.* at 19. He also falsely represented that he was a CPA and held Juris Doctor, Doctorate, and Master in Business Administration degrees. *Id.* In approximately January 2011, Lee's trading in client accounts created losses, and even though he had previously represented that he would share fifty percent of gains and losses with clients, Lee restructured billing invoices to spread losses over five months to continue receiving payments and show "perceived gains." *Id.* at 19-20. Between August 2009 and July 2013, Lee used over $500,000 in wires and checks from the shell corporation's bank account to pay his personal expenses. *Id.* at 20.

On August 28, 2008, based on Lee's conduct from mid-2002 through mid-2005 involving the unregistered offerings of billions of shares in penny stock companies, an Administrative Law Judge found Lee in default and ordered him to cease and desist from committing or causing violations of and any future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 and to disgorge ill-gotten gains of $2,866,375 plus prejudgment interest. *Alexander & Wade, Inc.*, Securities Act Release No. 8954, 2008 SEC LEXIS 2047, at *2, *11-12[2]; Ex. A at 8.

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[1] United States Magistrate Judge Barbara Lynn Major voiced concerns about Lee's honesty at the arraignment and change of plea hearing on October 9, 2014. Ex. E at 26. Judge Major noted that Lee had pled guilty to a second very serious crime, and that despite earning a significant amount of money, he had not made any significant effort to pay the fine or restitution relating to his 1997 conviction. *Id.* at 31.

[2] *See also Alexander & Wade, Inc.*, Admin. Proc. Rulings Release No. 767, 2013 SEC LEXIS 1801 (ALJ June 19, 2013). No finality order was issued.

**The Civil Case**

Based on the same conduct giving rise to the criminal case, a final judgment was entered by consent against Lee in the civil case on July 15, 2016, enjoining him from violating Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. OIP at 1; Ex. C at 1-3. The court held Lee liable for violating those provisions and ordered him to disgorge $1,880,263, representing profits from the conduct alleged in the complaint, and $322,762.95 in prejudgment interest.[3] Ex. C at 1-4. In consenting to the judgment, Lee agreed that "in any disciplinary proceeding before the Commission based on the entry of the injunction in this action, [he] understands that he shall not be permitted to contest the factual allegations of the complaint in this action." Ex. B at 4. He also agreed to "not make . . . any public statement to the effect that [he] does not admit the allegations of the complaint, or that [the] Consent contains no admission of the allegations." *Id.* Accordingly, based on the civil complaint[4] and the OIP, I find the following facts:

Lee is approximately sixty-one years old, has never held any securities licenses, and is a California resident who operated as an unregistered investment adviser from at least late 2008 through early 2012. OIP at 1; Ex. A at 4, 10, 16. In this period, Lee solicited investors in multiple states to open online brokerage accounts to trade stock options on their behalf and share in any profits. Ex. A at 6. Between March 2009 and the end of May 2011, at least twenty-four clients opened brokerage accounts to trade options through Lee. *Id.* Many of these clients had no options trading experience, and Lee exercised near complete control over their accounts. *Id.*

Between December 2008 and May 2011, Lee misled clients about his background to convince them he was trustworthy; among other things, he told them he had twenty years of experience trading securities and held several academic degrees yet failed to disclose his 1997 conviction and the 2008 administrative proceeding against him. *Id.* at 7-8. Lee also failed to disclose the risks of options trading, falsely assured certain clients that risk controls were in place, and promised that he would share in losses fifty/fifty. *Id.* at 9-11. However, Lee failed to share in client losses as he promised, and by early 2012 his clients had lost $11 million out of $25 million invested and had additionally paid over $3.3 million in fees, mostly to shell companies Lee controlled. *Id.* at 3, 10-11, 13. Lee repaid less than $200,000, and most of his

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[3] The court provided that Lee should receive credit for any payment made to satisfy restitution in the companion criminal case. Ex. C at 4.

[4] *See Nicholas Rowe*, Exchange Act Release No. 75982, 2015 SEC LEXIS 3928, at *16 (Sept. 24, 2015) ("When a respondent has consented to the entry of an injunction in an action brought by the Commission, and has agreed not to contest the allegations of the complaint in any later disciplinary proceeding brought by the Commission, we may rely on those allegations in making our public interest finding.").

clients received nothing.[5] *Id.* at 11. In his consent in the civil action, Lee acknowledged his admission in the criminal case that his "fraudulent conduct caused losses of over $10 million" for fourteen investor victims. Ex. B at 1.

## LEGAL CONCLUSIONS AND SANCTIONS

Under Section 203(f) of the Advisers Act, the Commission has authority to impose an industry bar on Lee if: (1) he was associated with an investment adviser at the time of the alleged misconduct; (2) he was enjoined "from engaging in or continuing any conduct or practice in connection with . . . activity" as a broker, dealer, or investment adviser, or "in connection with the purchase or sale of any security"; and (3) a bar is in the public interest. 15 U.S.C. § 80b-3(e)(4), (f).

Lee acted as an investment adviser,[6] and was therefore associated with one, satisfying the first requirement. *See Anthony J. Benincasa*, Advisers Act Release No. 1923, 2001 SEC LEXIS 2783, at *6 (Feb. 7, 2001) ("By functioning as an investment adviser in an individual capacity, [a respondent] will be in a position of control with respect to the investment adviser [that is, himself], and therefore, he meets the definition of a 'person associated with an investment adviser.'"); *Alexander V. Stein*, Advisers Act Release No. 1497, 1995 SEC LEXIS 3628, at *7 & n.10 (June 8, 1995) (Commission has authority under Section 203(f) where the respondent "acted as an investment adviser"). That Lee was an unregistered investment adviser is irrelevant. *See Teicher v. SEC*, 177 F.3d 1016, 1017-18 (D.C. Cir. 1999).

The second requirement is met because a district court enjoined Lee from violating the antifraud provisions of the Exchange Act, the Securities Act, and the Advisers Act, and therefore "from engaging in or continuing any conduct or practice in connection with [his] activity" as an investment adviser or "in connection with the purchase or sale of any security." 15 U.S.C. § 80b-3(e)(4), (f).

The third requirement is also met—barring Lee is in the public interest. The factors that the Commission uses to determine this indicate that Lee should receive a severe sanction. *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91

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[5] As to certain clients, Lee fraudulently charged fees based on overstated investment performance, and, in two client accounts, he traded in penny stocks without authorization. Ex. A at 11-12. Lee also misled a client who, at Lee's recommendation, invested $15,000 with a corporation that, at the time, had less than $700 in its bank account and that subsequently transferred $14,000 of the funds to companies and individuals associated with Lee. *Id.* at 12-13.

[6] Lee fits the statutory definition of an investment adviser, that is, "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. § 80b-2(a)(11). Moreover, Lee consented in the civil case to allegations that he was an investment adviser within the meaning of the Advisers Act's definition, and the OIP—accepted as true—also establishes Lee's status as an investment adviser. Ex. A at 16; Ex. B at 2; OIP at 1.

(1981). These factors are: (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. *Id.*

Lee's conduct was egregious. He misled clients about his background to gain their trust, made false assurances about risk controls and loss sharing, and in certain instances overstated investment performance to charge higher fees. Indeed, he admitted in the criminal case that his fraudulent conduct caused his clients to lose millions.[7] This egregiousness is confirmed by the fact of Lee's criminal conviction and civil injunction[8] based on the same conduct. This conduct benefited Lee and hurt his clients, and it occurred while Lee was acting as an investment adviser who by statute had a fiduciary duty to those clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963) (Congress has recognized an investment adviser to be a fiduciary); *Montford & Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *78 (May 2, 2014) ("Investors in the securities industry place a high degree of trust and confidence in the investment advisory relationship."), *pet. denied*, 793 F.3d 76 (D.C. Cir. 2015). Compounding this egregiousness is the fact that Lee's fraud occurred *after* his 1997 conviction for wire fraud and pension embezzlement *and* the administrative sanctions imposed on him in 2008.

Lee's violations were recurrent in nature because they involved numerous representations to potential investors, at least twenty-four clients, and extended for over two years. Ex. A at 6-14.

Lee acted with a high degree of scienter, defined as a mental state embracing intent to deceive, manipulate, or defraud. *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980). Most of the antifraud violations that Lee consented to being liable for in the civil case require scienter. *See* Ex. A at 3, 15-16; Ex. B at 2. Other evidence of scienter includes his efforts to "cover up" the undisclosed risk of his speculative options trading strategy, and his use of shell companies for billing and receiving payments for his investment advisory business. Ex. A at 2, 13-14.

By defaulting in this proceeding, Lee passed on the opportunity to provide any assurance that he will not commit future violations or that he recognizes the wrongful nature of his

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[7] The Commission also considers the degree of harm to investors when determining if remedial sanction is in the public interest. *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003).

[8] "The fact that a person has been [enjoined] . . . from violating the antifraud provisions has especially serious implications for the public interest[,] . . . and in the absence of evidence to the contrary, it will [ordinarily] be in the public interest to . . . bar from participation in the securities industry . . . a respondent who is enjoined from violating the antifraud provisions." *Marshall E. Melton*, 2003 SEC LEXIS 1767, at *30.

conduct. The assertion in the civil complaint that Lee is likely to continue to engage in the same or similar securities violations unless he was enjoined is unrefuted. Ex. A at 4.

The likelihood that Lee will commit future violations is overwhelming. Before embarking on the course of conduct that led to the civil case on which this follow-on proceeding is based, and before the companion criminal case, Lee was found guilty of wire fraud and pension embezzlement in 1997 and sentenced to serve thirty months in custody. Ex. D at 3; Ex. E at 16. Based on conduct following that conviction, he was ordered in a 2008 administrative proceeding to cease and desist from future violations of Sections 5(a) and 5(c) of the Securities Act.

Accordingly, imposing an industry bar against Lee is in the public interest.[9]

**ORDER**

Pursuant to Rule of Practice 155(a), 17 C.F.R. § 201.155(a), I GRANT the Division's motion for default and sanctions and ORDER, pursuant to Section 203(f) of the Investment Advisers Act of 1940, that James Y. Lee is BARRED from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

A respondent has the right to file a motion to set aside a default within a reasonable time, stating the reasons for the failure to appear or defend, and specifying the nature of the proposed defense. 17 C.F.R. § 201.155(b). The Commission can set aside a default at any time for good cause. *Id.*

This initial decision shall become effective in accordance with and subject to the provisions of Rule of Practice 360. 17 C.F.R. § 201.360. Pursuant to that Rule, I FURTHER ORDER that a party may file a petition for review of this initial decision within twenty-one days after service of the initial decision. 17 C.F.R. § 201.360(b). 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. 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 order resolving such motion to correct a manifest error of fact. This initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of

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[9] The Dodd-Frank Wall Street Reform and Consumer Protection Act, effective July 22, 2010, amended the securities laws to give the Commission authority to impose a bar covering multiple industry capacities based on a respondent's misconduct in only one such capacity. Pub. L. No. 111-203, §§ 4, 925, 124 Stat. 1376, 1390, 1850-51 (2010). Two circuit-level decisions have held that it is impermissibly retroactive to apply this change to a respondent whose relevant misconduct occurred wholly before the Dodd-Frank amendment. *Bartko v. SEC*, 845 F.3d 1217, 1224 (D.C. Cir. 2017); *Koch v. SEC*, 793 F.3d 147, 157-58 (D.C. Cir. 2015). *Bartko* and *Koch* are, however, consistent with imposing a multi-capacity industry bar here because Lee's relevant misconduct occurred into 2012, well after Dodd-Frank was enacted.

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 occur, the initial decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge