

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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 1478/June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15627

In the Matter of

TRI-STAR ADVISORS, INC.,
WILLIAM T. PAYNE, AND
JON C. VAUGHAN

ORDER DENYING SUMMARY
DISPOSITION MOTIONS AND
SCHEDULING PREHEARING
CONFERENCE

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on November 26, 2013, pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act) and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). The OIP alleges that from July 2009 through July 2011 (Relevant Period), Tri-Star Advisors, Inc. (TSA):

engaged in thousands of securities transactions with advisory clients on a principal basis through an affiliated broker-dealer, without providing prior written disclosure to, or obtaining consent from, the clients; and failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act.

OIP at 1. The OIP alleges further that these actions caused TSA to willfully violate Sections 206(3) and (4) of the Advisers Act and Advisers Act Rule 206(4)-7, and that William T. Payne (Payne) and Jon C. Vaughan (Vaughan) caused TSA's violations.¹ On January 22, 2014, Respondents jointly filed a single Answer.

At a February 7, 2014, prehearing conference, the Division of Enforcement (Division) took the position that most of the facts are not in dispute and the legal issues could be decided by

¹ "Willful" means intentionally committing the act that constitutes the violation. See *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). There is no requirement that a person be aware that he is violating a statute or regulation. Id.

a motion for summary disposition, but Respondents disagreed. Tr. 6-9, 12. The parties did agree, however, that it would be helpful to have motions for summary disposition on the legal issue of whether the individuals, Payne and Vaughan, are required to have committed the alleged violations with scienter. Tr. 7-12.

Both parties requested, and were granted, leave to file motions for summary disposition. See 17 C.F.R. § 201.250; Tr. 9-13; Tri-Star Advisors, Inc., Admin. Proc. Rulings Release No. 1274, 2014 SEC LEXIS 715 (Feb. 28, 2014); Admin. Proc. Rulings Release No. 1225, 2014 SEC LEXIS 490 (Feb. 10, 2014). Respondents filed a Motion for Summary Disposition Pursuant to Rule 250 of the Commission's Rules of Practice (Motion), with ten exhibits (Resp. Exs.) on February 28, 2014.² The Division filed its Motion for Summary Disposition and Response in Opposition to Respondents' Motion (Cross-Motion) on March 14, 2014, with one exhibit (Div. Ex. 1).³ Respondents filed a Reply Brief on March 31, 2014 (Resp. Reply Br.). The Division filed a Reply Brief (Div. Reply) in Support of its Summary Disposition Motion on April 11, 2014, with two exhibits (Div. Reply Exs. 1-2),⁴ and an Unopposed Motion for Leave to File Reply Brief on April 14, 2014. Respondents filed a Surreply Brief and an Unopposed Motion to File Surreply on April 17, 2014.

Undisputed Facts

TSA, a Texas corporation based in Houston, Texas, has been a registered investment adviser with the Commission since November 2009. OIP at 1-2; Answer at 1. Mutual Money Investments d/b/a Tri-Star Financial (TSF) is an affiliate of TSA; TSF has been registered with

² Resp. Ex. A is an excerpt of August 16, 2012, investigative testimony of Payne; Resp. Ex. B is an excerpt of August 16, 2012, investigative testimony of Vaughan; Resp. Ex. C is an excerpt of August 15, 2012, investigative testimony of Kelly Durham, TSA's chief compliance officer (Durham); Resp. Ex. 1 is an Agreement for Compliance Services between TSA and The Advisor's Resource, Inc. (Advisors' Resource) (attached to a February 15, 2013, email from Roy V. Washington (Washington) to R. Joann Harris (Harris)); Resp. Ex. 2 is a May 14, 2013, email from Washington to Harris regarding TSA; Resp. Ex. 3 is a March 23, 2011, letter from Frances M. From to Durham regarding a Commission examination of TSA; Resp. Ex. 4 is an August 31, 2011, deficiency letter from Donna C. Esau to Vaughan following the Commission's examination of TSA (Deficiency Letter); Resp. Ex. 5 is a November 29, 2011, letter from Vaughan to Karen Mysliwicz at the Commission responding to the examination's findings of deficiency at TSA; Resp. Ex. 6 is TSA's March 2011 Form ADV; Resp. Ex. 7 is TSA's March 2011 investment brochure.

³ Div. Ex. 1 contains fifty-three pages of letters and investigative testimony transcripts in support of its Cross Motion.

⁴ Div. Reply Ex. 1 is the Declaration of Linda Shirkey (Shirkey) and Div. Reply Ex. 2 is an excerpt from 2 Tamar Frankel & Ann Taylor Schwing, The Regulation of Money Managers, §§ 13.03, 14.02[B][2] at 13-57 & n.185, 14-80.1, and 14-80.2 (2d ed. 2013).

the Commission since 1993 as a broker-dealer. OIP at 2; Answer at 2. TSF is a Texas corporation also based in Houston, Texas. OIP at 2; Answer at 2.

Payne and Vaughan own both TSA and TSF. OIP at 2; Answer at 2; Resp. Ex. B at 63, Resp. Ex. 6 at 23. They are each fifty percent owners of TSA. Resp. Ex. 6 at 23; Form ADV (Mar. 25, 2014). Since September 2009, Payne has been TSA's CEO, Vaughan has been its President, and both have been controlling persons. OIP at 1; Answer at 1; Form ADV (Mar. 25, 2014).

Payne, Vaughan, and John Bott are principals of TSF. Motion at 2 n.2. Payne is President and forty percent owner of TSF, and Vaughan is Vice President and twenty percent owner of TSF. OIP at 2; Answer at 2. Payne and Vaughan were responsible for ensuring that TSA complied with its regulatory requirements.⁵ OIP at 2; Answer at 2.

As of December 2012, TSA managed approximately 313 accounts on a non-discretionary basis and had approximately \$162 million in assets under management. OIP at 2; Answer at 1. TSA's investment strategy is focused on fixed income securities, and it relied on TSF for fixed income analysis and trade execution. OIP at 2; Answer at 2. Payne and Vaughan made investment recommendations to TSA clients, and the transactions were executed through TSF. OIP at 2; Answer at 2. Payne and Vaughan initiated and were involved in executing trades through TSF. Answer at 3. TSF generally paid Payne and Vaughan fifty-five percent of the sales credits generated by TSF trades and TSF retained the rest. OIP at 2; Answer at 2. None of the gross sales credits were paid to TSA. OIP at 2; Answer at 2.

The Commission's Office of Compliance Inspections and Examinations conducted an examination of TSA in April 2011, and found violations by TSA of Advisers Act Section 206(3) and Advisers Act Rule 206(4)-7. Cross-Motion at 4, Div. Ex. 1 at PP. 0030-34.

Arguments of the Parties

Respondents' Arguments⁶

Respondents request that all claims against them be dismissed because:

- (a) Payne and Vaughan did not have the requisite *scienter* for "causing" liability under Sections 206(3) and (4) of the . . . Advisers Act. . . . and . . .

⁵ When advised that advance disclosure and client consent were necessary for the trades through TSF, TSA changed its practices. Answer at 4. TSA now makes advance disclosure and obtains advance client consent to trades handled through TSF. *Id.* at 4-5. TSA changed its policies and practices before being notified by the SEC of a deficiency. *Id.* at 5.

⁶ As the first filer of a motion for summary disposition, Respondents' arguments are set forth first.

(b) TSA did not knowingly engage in principal trades in violation of Section 206(3) and did not knowingly violate Section 206(4) of the Advisers Act.

Motion at 1-2, Resp. Reply Brief at 1 (emphasis in originals).

To find that TSA wilfully violated Section 206(3) of the Advisers Act, Respondents argue that the Division must show that TSA “knowingly” engaged in principal transactions as defined by the Commission. Motion at 14. Respondents assert that the Division cannot prove this because “TSA did not knowingly or recklessly disregard facts which would have indicated a problem. . . . On the contrary, by hiring and relying upon an eminently qualified compliance professional. . . , by voluntarily bringing the matter to the attention of the Staff, and by its full cooperation during the Staff’s examination, TSA has demonstrated its intent to comply and its unawareness of the principal trade issue.” Id. Respondents also claim that because TSA did not “knowingly” engage in principal transactions, it did not violate Advisers Act Section 206(4). Id.

Respondents argue that a parallel exists between this proceeding and SEC v. Slocum, Gordon & Co., 334 F. Supp. 2d 144 (D.R.I. 2004). Id. at 12. Respondents state that the principals’ unawareness of impropriety and the actions they took after learning of it in Slocum are similar to those of Payne and Vaughan. Id. In light of the facts of this administrative proceeding and the district court’s decision in Slocum, Respondents assert that Payne and Vaughan cannot be found to be “consciously involved in impropriety” and therefore all claims against them should be dismissed. Id. at 12-13 (quoting Slocum, 334 F. Supp. 2d at 184).

Respondents deny that the trades transacted through TSF were “principal” transactions under the meaning of the statute. Answer at 2. Respondents admit that bonds which TSA recommended to its clients could have passed through TSF’s inventory account, but contend that the inventory account was a holding account and not a proprietary trading account. Answer at 2. Respondents deny the OIP’s allegation of 2,212 violative principal transactions, and they claim that TSA either provided written disclosures to, or obtained consent from, clients before handling trades through TSF; moreover, Respondents claim Payne and Vaughan believed that TSA was providing those disclosures and obtaining requisite consents. Answer at 3. Respondents deny that TSA failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act regarding principal transactions. Id. According to Respondents, The Advisors’ Resource, Inc. (TARI), functioned as TSA’s compliance consultant throughout the Relevant Period and they relied on advice from Shirkey, TARI’s founder and president. Motion at 3-4; Surreply Brief at 1; Div. Reply at 1.

In the Resp. Reply Brief, Respondents reiterate and expand on their contentions that TSA did not knowingly engage in principal transactions in violation of Advisers Act Section 206(3) and that Payne and Vaughan did not have the requisite scienter to cause the violations. Resp. Reply Brief at 3-17. In their Surreply Brief, Respondents argue that a showing of reckless conduct is required for a Section 206(3) violation and the Division has not shown that TSA, through Payne and Vaughan, acted recklessly. Surreply Brief at 2-7.

Division's Arguments

The Division requests that its Cross-Motion be granted; Respondents' Motion be denied; that I find that "TSA willfully violated Advisers Act Sections 206(3) and 206(4) and Rule 206(4)-7 thereunder, and that Payne and Vaughan willfully caused . . . TSA's violations of the Advisers Act"; and that a briefing schedule be established to determine appropriate sanctions. Cross-Motion at 14. The Division argues that it is entitled to summary disposition against TSA for its willful violations of Sections 206(3) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and against Payne and Vaughan for willfully causing TSA's violations because there are no material facts in dispute.⁷ Id. at 5, 9. The Division characterizes Respondents' position as a claim that Payne and Vaughan "should escape liability for the violations because neither of them understood the federal securities laws." Id. at 1. The Division argues that the issue is purely legal and appropriate for disposition in its favor as scienter is not required for a violation of Section 206(3) or 206(4) of the Advisers Act. Id. at 2.

The Division's summary disposition arguments mirror the OIP's allegation that during the Relevant Period, "TSF used its inventory account to purchase mortgage-backed bonds for TSA advisory clients and then transferred the bonds to the applicable client account. TSF charged the advisory clients a sales credit for the trades, which was essentially a percentage mark-up (or mark-down)." OIP at 2. The Division alleges that during the Relevant Period, TSA engaged in 2,212 principal transactions with its advisory clients without providing requisite written disclosure to clients that it would effect the trades on a principal basis, or obtaining clients' consent. OIP at 2. The Division alleges Payne and Vaughan received over \$1 million in sales credits from TSF for those TSA principal trades during the relevant period." OIP at 2.

a. Primary Violations

The Division argues that TSA is liable for the actions of its officers, including Payne and Vaughan, and should be held liable for violations of the Advisers Act because the undisputed facts establish that TSA, through Payne and Vaughan, failed to follow proper disclosure and client consent procedures while engaging in principal trading transactions. Cross-Motion at 5-8.

The Division asserts that Respondents do not dispute that TSA engaged in principal trading, but they try to avoid liability by "inserting a *scienter* element into [Advisers Act] Section 206(3) that does not exist."⁸ Id. at 6 (emphasis in original). The Division states that

⁷ The Division acknowledges that its Cross-Motion was in error in alleging that Payne and Vaughan are liable for causing and aiding and abetting TSA's alleged primary violations. The Division affirms that Payne and Vaughan are charged only with causing TSA's alleged violations. Div. Reply at 1 n.1.

⁸ The Division defines a principal transaction as "when an adviser, acting for its own account, buys a security from, or sells a security to, the account of a client." Cross-Motion at 5 (citing Interpretation of Section 206(3) of the Investment Advisers Act of 1940, SEC Rel. No. IA-1732 (July 17, 1998), 1998 SEC LEXIS 1483, at *4).

Respondents misconstrue the word “knowingly” to impose a scienter requirement in the statute and argues instead that “the word . . . quite plainly modifies the act of purchasing, selling, or effecting a purchase or sale.” Id. at 7.⁹ The Division argues that if scienter were an element of the Section 206(3) primary violation, the law limits the standard to a showing that Respondents had an awareness of the underlying facts. Id. at 8. The Division argues, further, that the facts establish that TSA acted willfully because it intended to make principal trades in TSF’s inventory account. Id. at 8.

The Division also argues that TSA violated Advisers Act Section 206(4) and Rule 206(4)-7 by failing to implement disclosure and consent procedures for its principal trade transactions until November 2011. Id. at 8. The Division states that it is only required to show that TSA acted negligently, and that TSA did so by failing to exercise reasonable care, as a matter of law, in “failing to adopt policies and procedures that would prevent it from violating the disclosure and client consent rules” relating to its trades executed through TSF’s inventory accounts. Id.

b. Secondary Violations

The Division also argues that Payne and Vaughan caused TSA’s failure to adopt policies and procedures to prevent the violations of the Advisers Act. Id. at 13-14; Div. Reply at 1-4. The Division argues that Payne and Vaughan were responsible for insuring that TSA complied with the securities laws, and they were active participants in the formation of TSA’s policies and procedures. Cross-Motion at 14. According to the Division, “[t]he undisputed facts establish that Payne and Vaughan caused TSA to fail to adopt policies and procedures” that would have prevented TSA’s violation of the Advisers Act. Id. Respondents’ defense of reliance on compliance professionals in response to alleged violations of Advisers Act Section 206(4) and Rule 206(4)-7 is unsupported by any evidence, according to the Division. Id.

The Div. Reply is emphatic that Payne and Vaughan’s failure to exercise reasonable care caused TSA’s violations and retention of an outside compliance consultant who was told that TSA did not engage in principal trades cannot shield Respondents from liability. Div. Reply at 2-3; Div. Ex. 2 at 2.

Legal Conclusions that Impact Motion and Cross-Motion

Standard for Motions for Summary Disposition

Rule 250(b) of the Commission’s Rules of Practice provides that 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

⁹ The Division states that Respondents’ citations to cases interpreting the “knowing” element of Securities and Exchange Act of 1934 Section 13(b)(5) are inapposite and should be ignored. Cross-Motion at 7 n.3.

taken as true, except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noted pursuant to 17 C.F.R. § 201.323.

It is inappropriate in this context to make factual findings as to facts that remain in dispute. See Diane M. Keefe, Securities Exchange Act of 1934 Release No. 61928 (Apr. 16, 2010), 98 SEC Docket 27511, 27513 (“We have reviewed the *limited record* before us and believe that the record would benefit from direct and cross-examination of any relevant witnesses and the fact-finding determinations of a law judge.” (emphasis added)). Respondents admit many of the underlying facts alleged in the OIP, but argue that there are additional facts that, if established, would raise doubt that securities law violations occurred. Tr. 6-7.

Advisers Act Section 206(3)

“The Investment Advisers Act of 1940 . . . reflects a congressional recognition ‘of the delicate fiduciary nature of an investment advisory relationship,’ as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.” SEC v. Capital Gains Bureau, 375 U.S. 180, 191 (1963). Advisers Act Section 206(3), in relevant part, provides:

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –

. . . acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as a broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibition of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

15 U.S.C. § 80b-6.

a. The Transactions at Issue Constituted “Principal” Transactions

A principal transaction is one in which “an adviser, acting for its own account, buys a security from, or sells a security to, the account of a client.” Interpretation of Section 206(3) of the Advisers Act, 1998 SEC LEXIS 1483, at *4. Since 1998, the Commission has interpreted Section 206(3) to apply not only to principal and agency transactions engaged in or effected by any adviser, but also transactions “effected by a broker-dealer that controls, is controlled by, or is under common control with, the adviser.” Id. at *3 n.3 (citations omitted). TSA and TSF were under common control. TSA has admitted that TSF, an entity under common control with TSA, purchased and sold securities in its inventory account that it then distributed to TSA client

accounts. OIP at 2; Answer at 2. Thus, there is no question that TSA was acting as a principal in these transactions.

b. Advisers Act Section 206(3) Does Not Require a Showing that the Respondents “Knowingly” Acted as a Principal, and No Showing of Scienter is Required

Contrary to Respondents’ contention, the term “knowingly” in Advisers Act Section 206(3) does not require a showing that an adviser knew “it was engaged in principal transactions as defined by the Commission.” Motion at 13-14. I rely on the plain meaning of the statute provided by Congress that is clear and unambiguous on its face. See Connecticut Nat’l Bank v. Germain, 503 U.S. 249, 253-54. Section 206(3) states “knowingly to sell any security to or purchase any security from a client, or acting as a broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client.” Clearly, there is no requirement that an adviser know the purchase or sale of securities was a principal transaction.¹⁰

Similarly, no showing of scienter is required for Section 206(3). Scienter is defined as “a mental state embracing intent to deceive, manipulate, or defraud,”¹¹ and is an element of a Commission enforcement action brought “pursuant to the antifraud provisions of the Securities Acts.” SEC v. Rubera, 350 F.3d 1084, 1094 (9th Cir. 2003). Though no court has directly opined on whether Advisers Act Section 206(3) requires a showing of scienter, the context of the statute shows that scienter is not an element. See, e.g., Laird v. Integrated Res., Inc., 897 F.2d 826, 836 & n.37 (5th Cir. 1990) (“A cause of action under rule 10(b)-5 requires proof of scienter. In contrast, a cause of action under the antifraud sections of the Investment Advisors Act may not.”) (internal citations omitted). Advisers Act Section 206(1), providing that it “shall be unlawful for any investment adviser . . . to employ any device, scheme, or artifice to defraud any client or prospective client,” requires a showing of scienter. 15 U.S.C. § 80b-6(1); see Steadman v. SEC, 603 F.2d 1126, 1134 (5th Cir. 1979) aff’d on other grounds 450 U.S. 91 (1981). Section 206(3), unlike Section 206(1), does not include any language relating to fraud, and the Commission has stated that Section 206(3) “can be violated without a showing of fraud.” Marc N. Geman, 54 S.E.C. 1226, 1242 (“Whether [the respondent] made the disclosure or came within the exception of Section 206(3) is a separate matter from whether it defrauded its customers under Sections 206(1) and (2) and the other antifraud provisions charged.”), aff’d 334 F.3d 1183 (10th Cir. 2003).

¹⁰ Following accepted rules of grammar, the word “knowingly” in Advisers Act 206(3) modifies the immediately following verbs “to sell” and “to purchase,” not the participle “acting” that precedes it. See, e.g., The Chicago Manual of Style 185-87 (15th ed. 2003). The fact that the term “knowingly” is used twice in the statute, and both uses are placed in front of the actions “to sell” or “to purchase” and “to effect any sale” or “to effect any purchase,” make clear that the statute’s use of the term “knowingly” applies to those actions, and not upon the predicate element “acting as principal.”

¹¹ Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980) (internal quotations omitted).

Investment Company Act Section 17, which deals with principal transactions of investment companies with affiliates, similarly uses the word “knowingly.” Courts have decided that a violation of Investment Company Act Section 17(a) does not require scienter,¹² and that its use of the word “knowingly” implies knowledge that the transaction occurred, not that the transaction was wrongful. 2 Tamar Frankel & Ann Taylor Schwing, The Regulation of Money Managers §§ 14.01[G] at 14-47 (2d ed. Supp. 2010) & 14.80-1–80.2, (2d ed. Supp. 2012); see also Howard v. SEC, 376 F.3d 1136, 1141 n.5 (D.C. Cir. 2004); Investors Research Corp. v. SEC, 628 F.2d 168, 176-78 (D.C. Cir. 1980).

For the purpose of ruling on the Motion, a showing that TSA knew, through its officers, that the TSF inventory account was used to purchase bonds that TSF distributed to TSA’s clients would appear to satisfy the statute.

Advisers Act Section 206(4) and Rule 206(4)-7 Do Not Require a Showing of Scienter

The OIP charges that TSA willfully violated Advisers Act Section 206(4) and Advisers Act Rule 206(4)-7 and that Payne and Vaughan caused TSA’s violations. Section 206(4) provides, in relevant part, “It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly -- . . . to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.”¹³ 15 U.S.C. § 80b-6(4).

Advisers Act Section 206(4) requires a lower standard of intent than Section 206(1). SEC v. Blavin, 557 F. Supp. 1304, 1315 (E.D. Mich.) (Section 206(1), unlike Section 206(4), requires a showing of a scheme to defraud), aff’d 760 F.2d 706 (6th Cir. 1985). A showing of negligence is all that is required to support a violation of Section 206(4). See SEC v. Quan, No. 11-cv-723, 2013 WL 5566252, at *16 (D. Minn. Oct. 18, 2013); SEC v. Steadman, 967 F.2d 636, 647 (D.C. Cir. 1992).

Subsection (4) was added in 1960 to authorize the SEC to issue regulations defining and preventing fraudulent practices, thus enabling the SEC to deal adequately with misleading advertising and with problems presented by conflicts

¹² Compare 15 U.S.C. § 80a-17 (“It shall be unlawful for any affiliated person . . . , acting as principal – (1) knowingly to sell any security or other property . . . [or] (2) knowingly to purchase . . . any security or other property.”) with 15 U.S.C. § 80b-6(3) (“It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly— . . . acting as principal for his own account, knowingly to sell any security to or purchase any security from a client.”).

¹³ Advisers Act Rule 206(4)-7 provides, in relevant part, that it is unlawful for a registered investment adviser to provide investment advice to clients unless the adviser adopts and implements written policies and procedures reasonably designed to prevent violation, by it and its supervised persons, of the Act and the rules that the Commission has adopted under the Act. 17 C.F.R. § 275.206(4)-7.

of interest in an adviser's recommendations. Addition of subsection (4), designed to tighten the antifraud provisions of the Advisers Act, does not justify a narrow interpretation of the Act. (citations omitted)

2 Tamar Frankel & Ann Taylor Schwing, The Regulation of Money Managers, § 11.02 at 11-7 (2d ed. Supplement 2009).

Good faith reliance on TARI, even if proved, would not be an absolute defense to violation of Advisers Act Section 206(4) and Rule 206(4)-7. "Good faith reliance on the advice of an accountant or another professional has been recognized as a viable defense to *scienter* in securities fraud cases." SEC v. Johnson, 174 F. App'x 111, 114-15 (3rd Cir. 2006) (emphasis added). No showing of *scienter* is required here, and thus Respondents' Motion cannot be granted.

Scienter is Not Required to Prove "Causing" Violations

For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. Robert M. Fuller, 56 S.E.C. 976, 984 (2003), pet. for review denied, 95 F. App'x 361 (D.C. Cir. 2004) (per curiam).¹⁴

Moreover, regulated entities and their principals are required to know the applicable rules and to operate accordingly. See Robert L. Burns, Advisers Act Release No. 3260 (Aug. 5, 2011), 101 SEC Docket 44807, 44826 n.60 ("We have repeatedly held that ignorance of the securities laws is not a defense to liability thereunder.") (citing Geman, 54 S.E.C. at 1260). In Geman, the Commission held "securities professionals . . . are part of a highly regulated industry and, as such, required to know the law that is applicable to their conduct within that industry." 54 S.E.C. at 1260.

Because no primary violations have been established at this point, the Division's Cross-Motion must also be denied as to the alleged causing violations.

¹⁴ Respondents cite to a number of cases in their Motion to show that various respondents were found liable for aiding, abetting, and causing violations upon a showing of some level of *scienter* or knowledge. Motion at 6-9. It is true that a respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. See Sharon M. Graham, 53 S.E.C. 1072, 1085 n.35 (1998) aff'd 222 F.3d 994 (D.C. Cir. 2000). However, the reverse is not necessarily true. The standard for causing is different than the standard for aiding and abetting. See, e.g., Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000) (For "aiding and abetting" liability under the federal securities laws, three elements must be established: (1) a primary or independent securities law violation committed by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation.).

Order

For the reasons stated, I DENY Respondents' Motion for Summary Disposition, which would dismiss the proceeding, and I DENY the Division of Enforcement's Cross-Motion for Summary Disposition.

I ORDER that a telephonic prehearing conference be held on Monday, June 9, 2014, at 10:00 a.m. EDT to determine the time and location for the hearing Respondents want, and at which the Division will state what relief it would request if the allegations are shown to be true. The deadline for an Initial Decision is September 29, 2014, so the parties can expect to operate on an expedited hearing schedule.

Brenda P. Murray
Chief Administrative Law Judge