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

Administrative Proceedings Rulings
Release No. 5233 / November 17, 2017

Administrative Proceeding
File No. 3-18127

In the Matter of

Martin Shkreli

Order on Motion for Summary Disposition

The Division of Enforcement moves for summary disposition and argues that Respondent Martin Shkreli should be barred from the securities industry. Shkreli opposes the Division's motion. For the reasons discussed below, the Division's motion is granted in part and denied in part.

Procedural Background

The Securities and Exchange Commission instituted this proceeding against Shkreli in August 2017. The order instituting proceedings (OIP), which was issued under Section 203(f) of the Investment Advisers Act of 1940, alleges that during an unspecified timeframe, Shkreli was the managing partner and portfolio manager for two hedge funds.[1] It also alleges that in August 2017, a jury convicted Shkreli of violating Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (securities fraud), and 18 U.S.C. § 371 (conspiracy).[2] The OIP summarizes the factual allegations in the superseding indictment related to the charges of which Shkreli was convicted.[3] The OIP directs me to determine whether the allegations are true and, if so, what "remedial action is appropriate."[4]

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1 OIP ¶ II.A.1.

2 *Id.* ¶ II.B.2.

3 *Id.* ¶ II.B.3.

4 *Id.* ¶¶ III.A–B.

Shkreli filed a timely answer to the OIP. Shkreli, who has not yet been sentenced, declined on Fifth Amendment grounds to answer the first operative paragraph of the OIP, which included the allegations related to his alleged association with a hedge fund.[5] He admitted, however, the fact of the verdict rendered against him and the accuracy of the OIP's summary of the allegations included in his superseding indictment.[6]

In accordance with a schedule that I set,[7] the Division filed a motion for summary disposition, which Shkreli opposes.

Legal Principles

Cases such as Shkreli's, which are based on a conviction or injunction, are known as *follow-on* proceedings. "[S]ummary disposition is ordinarily appropriate in follow-on proceedings."[8] In moving for summary disposition in a follow-on proceeding instituted under the 75-day timeframe described in Rule of Practice 360(a)(2), a movant must show that "there is no genuine issue with regard to any material fact and that the movant is entitled to summary disposition as a matter of law."[9] When considering a motion for summary disposition, the Commission "view[s] the evidence and factual inferences 'in the light most favorable to the nonmoving party.'"[10]

Although a guilty plea constitutes an admission of the facts alleged in an indictment or information,[11] a general jury verdict of guilt establishes only

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5 Answer ¶ 4.

6 *Id*. ¶¶ 5–6.

7 *Martin Shkreli*, Admin. Proc. Rulings Release No. 5076, 2017 SEC LEXIS 2935, at *1 (ALJ Sept. 21, 2017) (finding, in addition, that the parties agreed that the Division made its investigative file available to Shkreli).

8 *James S. Tagliaferri*, Advisers Act Release No. 4650, 2017 WL 632134, at *7 (Feb. 15, 2017).

9 17 C.F.R. § 201.250(b).

10 *Joseph P. Doxey*, Securities Act of 1933 Release No. 10077, 2016 WL 2593988, at *1 n.1 (May 5, 2016) (quoting *SEC v. Monterosso*, 756 F.3d 1326, 1333 (11th Cir. 2014)); Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,224 n.112 (July 29, 2016).

11 *United States v. Broce*, 488 U.S. 563, 570 (1989); *Coleman v. Burnett*, 477 F.2d 1187, 1193 (D.C. Cir. 1973); *United States v. Smith*, 407 F.2d 33, 35 (2d Cir. 1969).

those "issues which were essential to the verdict,"[12] *i.e.*, those "questions 'distinctly put in issue and directly determined' in the criminal prosecution."[13] To determine what was decided by a jury in an earlier criminal case, one must examine the record in the criminal case, "including the pleadings, the evidence submitted, the instructions under which the jury arrived at its verdict, and any opinions of the courts."[14] The burden to show that an issue was actually decided rests on the party seeking to invoke preclusion.[15] In line with this guidance, the Commission has held that a general jury verdict alone does not establish the facts alleged in an indictment and that additional evidence must be considered in conducting the public-interest analysis.[16]

Like Federal Rule of Civil Procedure 8(b)(6), Commission Rule of Practice 220(c) provides that any allegation not denied in a respondent's answer will be deemed admitted.[17] The rule that allegations not denied are admitted does not apply when the failure to deny results from a party's invocation of his or her Fifth Amendment right against self-incrimination.[18]

Discussion

Under Section 203(f) of the Advisers Act, the Commission may bar or suspend an individual from the securities industry if the Division establishes

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12 *Emich Motors Corp. v. Gen. Motors Corp.*, 340 U.S. 558, 569 (1951).

13 *Hemphill v. Schott*, 141 F.3d 412, 416 (2d Cir. 1998) (quoting *Emich Motors*, 340 U.S. at 568–69).

14 *Emich Motors*, 340 U.S. at 569 (prior conviction); *see Ashe v. Swenson*, 397 U.S. 436, 444 (1970) (requiring a similar inquiry to determine the preclusive effect of an acquittal).

15 *Cf. Schiro v. Farley*, 510 U.S. 222, 233 (1994) (holding that a defendant bore the burden to show that a prior acquittal precluded trial court from finding presence of aggravating factor necessary for death penalty).

16 *Gary L. McDuff*, Securities Exchange Act of 1934 Release No. 74803, 2015 WL 1873119, at *3 (Apr. 23, 2015).

17 17 C.F.R. § 201.220(c).

18 *See* 5 Charles Alan Wright et al., *Federal Practice and Procedure* § 1280 (3d ed. Apr. 2017 update); *see also N. River Ins. Co. v. Stefanou*, 831 F.2d 484, 486 (4th Cir. 1987); *Nat'l Acceptance Co. of Am. v. Bathalter*, 705 F.2d 924, 930 (7th Cir. 1983).

three prerequisites: (1) within the preceding ten years the individual (a) willfully violated any provision of the Exchange Act, or (b) was convicted of a felony involving the purchase or sale of any security; (2) the individual was associated with an investment adviser at the time of his misconduct; and (3) imposing a bar or suspension would be in the public interest.[19]

As to the first prerequisite, in August 2017, a jury found Shkreli guilty of two counts of securities fraud in violation of Exchange Act Section 10(b) and one count of conspiracy to commit securities fraud.[20] The term *convicted* includes a guilty verdict.[21] Because Shkreli's offenses are punishable by terms of imprisonment in excess of one year, he has been convicted of a felony.[22] By its terms, a violation of Section 10(b) occurs "in connection with the purchase or sale of any security."[23] Shkreli's securities fraud convictions, involving violations of Exchange Act Section 10(b) within the last ten years, suffice to establish that he was convicted of a felony involving the purchase or sale of any security.[24] His convictions for violating Section 10(b) of the Exchange Act also establish that he willfully violated a provision of the Exchange Act.[25] The Division is thus entitled to summary disposition on the question of whether, within the last ten years, Shkreli willfully violated any provision of the Securities Exchange Act or was convicted of a felony involving the purchase or sale of any security.

As to the second prerequisite, the Division does not directly address when Shkreli's misconduct occurred or whether he was associated with an

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19 15 U.S.C. § 80b-3(e)(2)(A), (e)(5), (f).

20 Div. Ex. C; *see* 15 U.S.C. § 78j(b); 18 U.S.C. § 371.

21 *See* 15 U.S.C. § 80b-2(a)(6).

22 *See* 15 U.S.C. § 78ff(a) (violations of Exchange Act); 18 U.S.C. §§ 371 (conspiracy), 3559(a) (classifying offenses).

23 15 U.S.C. § 78j(b).

24 *See James S. Tagliaferri*, 2017 WL 632134, at *3; *Toby G. Scammell*, Advisers Act Release No. 3961, 2014 WL 5493265, at *4 (Oct. 29, 2014) (holding that a person enjoined from violating Section 10eb) had been enjoined from any conduct or practice in connection with the purchase or sale of a security).

25 *See* 15 U.S.C. § 78ff(a) (limiting criminal liability for violations of the Exchange Act to willful conduct); *United States v. Vilar*, 729 F.3d 62, 75 (2d Cir. 2013); *James S. Tagliaferri*, 2017 WL 632134, at *3.

investment adviser *at the time of his misconduct*.[26] Citing the first operative paragraph of the OIP and Shkreli's invocation in his answer of his Fifth Amendment privilege against self-incrimination, the Division asserts that he "was the managing partner and portfolio manager for two hedge funds."[27] It is true that the first operative paragraph contains the allegations that Shkreli was at one point the portfolio manager for MSMB Capital Management LP and MSMB Healthcare LP. But that paragraph does not specify *when* Shkreli occupied these positions. And even if it did specify, Shkreli's Fifth Amendment invocation during the pleading stage of this proceeding operated as an implied denial, not as an admission, of the factual allegations.[28]

The Division notes that paragraphs three and four of the superseding indictment include allegations that Shkreli controlled investment advisers MSMB Capital Management LLC and MSMB Healthcare Management LLC.[29] But the superseding indictment does not allege the time period of that control. More importantly, the Division does not contend that the jury necessarily concluded that either entity was an investment adviser or that Shkreli controlled them. It also does not engage in the analysis required by Supreme Court precedent or submit relevant portions of the record to determine what factual questions were "distinctly put in issue and directly determined in [Shkreli's] criminal prosecution."[30]

The Division relies on Shkreli's sworn investigative testimony in which he conceded "that he provided investment advisory services to the MSMB Partnerships."[31] Shkreli's investigative testimony establishes that he was the

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[26] Section 203(f) also allows the imposition of a bar or suspension if a respondent is *currently* associated or "seeking to become associated" with an investment adviser. 15 U.S.C. § 80b-3(f). The Division concedes that Shkreli is not currently associated with an investment adviser. Mot. at 2.

[27] Mot. at 2 & n.1.

[28] *See supra* note 18. In its reply, the Division suggests that I should apply an adverse inference. Reply at 2 & n.1. But the cases on which it relies do not involve invocation of the Fifth Amendment in an answer. *See id.*

[29] Mot. at 2; *see* Div. Ex. A at 2.

[30] *Hemphill*, 141 F.3d at 416 (internal quotation marks omitted); *see* Opp'n at 5–7.

[31] Mot. at 2; *see* Div. Ex. E.

general partner to MSMB Capital Management LP, which was formed in 2009.[32] Shkreli was also the managing member of MSMB Capital Management LLC, which served as the investment adviser to MSMB Capital Management LP.[33] Shkreli's testimony further establishes that he formed MSMB Healthcare LP, which was a fund that invested in "healthcare related investment opportunities."[34] Shkreli was the managing member of (1) MSMB Healthcare Investors LLC, which was the general partner of MSMB Healthcare LP, and (2) MSMB Healthcare Management LLC, which was the investment adviser to MSMB Healthcare LP.[35] MSMB Healthcare LP was liquidated in December 2012.[36]

Taking this evidence in the light most favorable to Shkreli, as the non-moving party,[37] the most that can be said is that Shkreli was associated with MSMB Capital Management LLC, which was an investment adviser, sometime after MSMB Capital Management LP was formed in 2009. And he was associated with MSMB Healthcare Management LLC, also an investment adviser, at some point prior to December 2012 when MSMB Healthcare LP closed. Based on the evidence submitted, the most I can say is that Shkreli was associated with MSMB Capital Management LLC for an unknown period starting in 2009. And his association with MSMB Healthcare Management LLC, whose role as an adviser ended in 2012 when MSMB Healthcare LP closed, began at an undetermined time before December 2012.

Turning to the three counts of the superseding indictment on which Shkreli was convicted, count three alleged that Shkreli committed securities fraud "[i]n or about or between September 2009 and September 2014."[38] Count six alleged that Shkreli committed securities fraud "[i]n or about or between February 2011 and September 2014."[39] And count eight alleged that

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[32] Div. Ex. E at 12.

[33] *Id.* at 12–13.

[34] *Id.* at 246–47.

[35] *Id.* at 248, 253.

[36] *Id.* at 248.

[37] *See Joseph P. Doxey*, 2016 WL 2593988, at *1 n.1.

[38] Div. Ex. A at 25.

[39] *Id.* at 29.

Shkreli engaged in a conspiracy to commit securities fraud from November 2012 to September 2014.[40] These allegations cover a broad period of time. It is possible that the jury based its convictions on Shkreli's conduct in 2013 and 2014 only. Shkreli's investigative testimony, however, establishes his association with an investment advisor only through 2012. The superseding indictment does not, therefore, show that Shkreli's misconduct necessarily overlapped with the time, reflected in his investigative testimony, when he was associated with an investment adviser.

Given the foregoing, there is a material question as to whether Shkreli was associated with an investment adviser at the time of his misconduct. To the extent the Division moves for summary disposition on this issue, the motion is denied.[41]

As to the public interest, the Division has established that Shkreli was convicted of criminal offenses involving fraud. And the Commission has observed that summary disposition will "rare[ly]" be inappropriate in cases involving fraud convictions.[42] Even so, the Commission and the courts have made clear that a bar does not automatically result from a conviction[43]—otherwise there would be no need for this proceeding—and an individual assessment of the public interest in each case is required.[44]

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[40] *Id*. at 30.

[41] Shkreli did not contest whether the Division met its burden on this issue. The initial burden, however, rests on the Division. Its failure to meet that burden means it would be error to grant the Division's motion regardless of Shkreli's failure to address this point. *See Vermont Teddy Bear Co. v. 1-800 Beargram Co*., 373 F.3d 241, 244 (2d Cir. 2004).

[42] *See James S. Tagliaferri*, 2017 WL 632134, at *7 n.45; *cf. Chris G. Gunderson, Esq*., Exchange Act Release No. 61234, 2009 WL 4981617, at *5 (Dec. 23, 2009) ("an antifraud injunction 'ordinarily' warrants barring participation in the securities industry").

[43] *See James S. Tagliaferri*, 2017 WL 632134, at *7 n.45.

[44] *See Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416, at *2 (Mar. 7, 2014), *vacated in part on other grounds*, Exchange Act Release No. 77935, 2016 WL 3030883 (May 26, 2016); *see also McCarthy v. SEC*, 406 F.3d 179, 189 (D.C. Cir. 2005) (remarking on the Commission's failure to "devote individual attention to the unique facts and circumstances of [a] case").

The problem here is that the Division principally relies on the superseding indictment and the jury's verdict. But it has not supplied the evidence necessary to determine what the jury necessarily decided when it convicted Shkreli. This problem is accentuated here because Shkreli was acquitted of five of the eight counts in the superseding indictment.[45] Given the length of the 21-page factual recitation that precedes the first count in the superseding indictment, I cannot without more evidence reliably determine the facts on which the jury relied.[46] And without knowing what the jury necessarily decided, it is not possible to rely on the factual allegations in Shkreli's superseding indictment.[47] To the extent the Division seeks summary disposition on the question of whether the public interest supports barring Shkreli, the Division's motion is denied.[48]

Order

In summary, I GRANT IN PART summary disposition on the question of whether, within the last ten years, Shkreli willfully violated any provision of the Securities Exchange Act or was convicted of a felony involving the purchase or sale of any security. Summary disposition is OTHERWISE DENIED. In light of Shkreli's current custody status, the parties should confer about how best to conduct the hearing currently scheduled to begin January 31, 2018. The parties should file a joint letter regarding their discussion, including information regarding where the hearing should take place, how Shkreli can best participate, and how long the hearing will take, by November 30, 2017.

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[45] Div. Ex. C.

[46] *Cf. United States v. Tramunti*, 500 F.2d 1334, 1346 (2d Cir. 1974) ("Since it is usually impossible to determine with any precision upon what basis the jury reached a verdict in a criminal case, it is a rare situation in which the collateral estoppel defense will be available to a defendant."). The Division seems to concede that one cannot know the factual allegations on which the jury relied. Reply at 2–3 ("His convictions on three separate counts show that he repeatedly engaged in fraudulent conduct with scienter, even if the specific conduct was not found.").

[47] *See Hemphill,* 141 F.3d at 416.

[48] *Cf. Gary L. McDuff*, 2015 WL 1873119, at *3 (remanding because the administrative law judge "erred in relying on the allegations in the superseding indictment in his sanctions analysis").

In his opposition, Shkreli moved to stay this proceeding. I will adjudicate that motion by separate order.

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James E. Grimes
Administrative Law Judge