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

Administrative Proceedings Rulings
Release No. 6349 / November 20, 2018

Administrative Proceeding
File No. 3-17621

In the Matter of

Andrew Stitt

Order Denying the Division of Enforcement's Motion for Default

The Division of Enforcement moves for an order imposing sanctions by default and argues that Respondent Andrew Stitt should be barred from the securities industry. Stitt, who has not participated in this proceeding, has not responded to the Division's motion. For the reasons discussed below, the Division's motion is denied without prejudice to renewal.

Procedural Background

The Securities and Exchange Commission instituted this proceeding against Stitt in October 2016. The order instituting proceedings (OIP), which was issued under Section 15(b) of the Securities Exchange Act of 1934, alleges that during an unspecified timeframe, Stitt "offered and sold interests in three unregistered securities offerings."[1] It also alleges that "he received undisclosed commissions," but was never registered with the Commission as a broker-dealer nor associated with a registered broker-dealer.[2] According to the OIP, the United States District Court for the Northern District of Texas permanently enjoined Stitt in August 2016, from committing future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act, and Exchange Act Rule 10b-5.[3]

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1 OIP ¶ II.A.1.

2 *Id.*

3 *Id.* ¶ II.B.2; *see also SEC v. Team Res., Inc.*, No. 3:15-cv-1045 (N.D. Tex. Aug. 18, 2016), ECF Nos. 37, 38.

The operative portion of the OIP concludes by summarizing the factual allegations in the Commission's injunctive complaint.[4] The OIP directs me to determine whether the allegations are true and, if so, what "remedial action is appropriate."[5]

A different administrative law judge originally presided over this proceeding and issued an initial decision imposing sanctions by default.[6] Although the Commission issued a finality order, it later vacated the initial decision and the finality order and remanded this case.[7] It also ordered that this case be reassigned for a new hearing.[8] Following remand, this matter was reassigned to me.[9]

In an order issued in October 2018, I determined that Stitt had been served with the OIP in December 2017.[10] Because he never answered the OIP, I ordered Stitt to show cause by October 25, 2018, why he should not be found in default.[11] I also directed that if Stitt failed to show cause, "the Division should file a notice … stating whether it intends to rely on the existing record or to supplement or substitute its previous filings."[12] Finally, I

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4 OIP ¶ II.B.3.

5 *Id.* ¶¶ III.A–C.

6 *See Andrew Stitt*, Initial Decision Release No. 1231, 2018 WL 637806 (ALJ Jan. 30, 2018).

7 *Pending Admin. Proc.*, Securities Act Release No. 10536, 2018 WL 4003609, at *1 (Aug. 22, 2018).

8 *Id.*

9 *Pending Admin. Proc.*, Admin. Proc. Rulings Release No. 5955, 2018 SEC LEXIS 2264, at *2–3 (ALJ Sept. 12, 2018). Under the Commission's order, I cannot give weight to or otherwise presume the correctness of any prior opinions, orders, or rulings issued by the prior administrative law judge. *Pending Admin. Proc.*, 2018 WL 4003609, at *1.

10 *Andrew Stitt*, Admin. Proc. Rulings Release No. 6188, 2018 SEC LEXIS 2840, at *3 (ALJ Oct. 15, 2018).

11 *Id.*

12 *Id.* at *4.

ordered the parties to participate in a telephonic prehearing conference in early November 2018.[13]

In advance of the conference, the Division filed "notice that it intends to rely upon the existing record." Counsel for the Division participated in the conference, but Stitt did not. During the conference, I confirmed with counsel the evidence on which the Division intended to rely. After discussing the evidence in light of Commission precedent, I offered the Division until November 30, 2018, to "submit a supplemental filing with additional evidence."[14]

Within a few days, however, the Division declined to file additional evidence, arguing that the existing record—factual allegations in the OIP deemed true by virtue of Stitt's default, the injunctive complaint, and the district court's injunction—supported imposing "associational and penny stock bars."

Legal Principles

As a general matter, judgments entered by default do not have preclusive effect in later litigation,[15] because default judgments do not "result[] … from a decision on the merits."[16] Recognizing this principle, the Commission has held that when assessing the public interest in a follow-on

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[13] *Id.*

[14] *Andrew Stitt*, Admin. Proc. Rulings Release No. 6290, 2018 SEC LEXIS 3147, at *1 (ALJ Nov. 5, 2018).

[15] *In re McMillan*, 579 F.2d 289, 293 (3d Cir. 1978) ("the preponderant view is that … a default judgment has no collateral estoppel effect"); *see Abrams v. Interco Inc.*, 719 F.2d 23, 33 n.9 (2d Cir. 1983) (Friendly, J.) (noting the "accepted view that the decision of issues not actually litigated, *e.g.*, a default judgment, has no preclusive effect in other litigation"); *In re Gottheiner*, 703 F.2d 1136, 1140 (9th Cir. 1983) ("the default judgment is not given collateral estoppel effect").

[16] 10 James Wm. Moore et al., Moore's Federal Practice - Civil ¶ 55.83[2] (3d ed. 2018); *see Spilman v. Harley*, 656 F.2d 224, 228 (6th Cir. 1981) ("If the important issues were not actually litigated in the prior proceeding, as is the case with a default judgment, then collateral estoppel does not bar relitigation in the bankruptcy court.").

case, it must be provided with more than just a default injunction and an injunctive complaint.[17]

If a respondent fails to answer the OIP and is found in default, an administrative law judge may deem true the allegations in the OIP.[18]

Discussion

Under Section 15(b) of the Exchange Act, the Commission may bar or suspend an individual from the securities industry if the Division establishes three prerequisites: (1) the individual has been permanently enjoined "from engaging in or continuing any conduct or practice … in connection with the purchase or sale of any security"; (2) the individual is currently or was, at the time of his misconduct, associated with or seeking to be associated with a broker or dealer; and (3) imposing a bar or suspension would be in the public interest.[19]

As to the first prerequisite, I take official notice of the docket in *SEC v. Team Res., Inc.*, No. 3:15-cv-1045 (N.D. Tex.), which is the litigation on which this proceeding is based.[20] The docket reflects that in August 2016, Stitt was permanently enjoined from committing future violations of Securities Act Sections 5(a), 5(c), and 17(a), Exchange Act Sections 10(b) and 15(a), and Exchange Act Rule 10b-5. By definition, Stitt was enjoined "from engaging in or continuing any conduct or practice … in connection with the purchase or sale of any security."[21] The first prerequisite has thus been established.

As to the second prerequisite, the Division does not directly address whether Stitt is currently or was associated with or seeking to be associated

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[17] *Don Warner Reinhard*, Exchange Act Release No. 61506, 2010 WL 421305, at *4 & nn.25–26 (Feb. 4, 2010); *see also Gary L. McDuff*, Exchange Act Release No. 74803, 2015 WL 1873119, at *2 & n.14 (Apr. 23, 2015) (holding that although "the Commission has given preclusive effect to substantive findings that have *accompanied* the entry of default," a district court's default judgment did "not, by itself, provide an adequate basis for finding that [a respondent] acted as an unregistered broker-dealer").

[18] 17 C.F.R. §§ 201.155(a), .220(c).

[19] 15 U.S.C. § 78*o*(b)(4)(C), (6)(A)(iii).

[20] *See* 17 C.F.R. § 201.323 (rule of practice relating to official notice).

[21] *See* 15 U.S.C. §§ 77e(a), (c), 77*o*(a), 78j(b), 78*o*(a); 17 C.F.R. § 240.10b-5.

with a broker or dealer. And assuming he was so associated, it does not address whether that association *is current* or *occurred at the time of his misconduct*.

It is tempting to say that because Stitt was enjoined from violating Section 15(a) of the Exchange Act, which prohibits acting as an unregistered broker or dealer, he was associated with a broker or dealer—himself—at the time of his misconduct.[22] But Stitt's injunction was entered by default and therefore does not establish any fact other than that he was enjoined.

The first paragraph of the OIP alleges that Stitt "received undisclosed commissions" "[i]n exchange" for interests he sold in unregistered securities offerings. And if I find Stitt in default, I can deem these allegations true.[23] Because receipt of commissions is a strong indicator that one is a broker, this allegation, if deemed true, *could* show that Stitt was associated with a broker.[24] But "determining whether [a respondent] was acting as an unregistered broker-dealer involves the consideration of several factors."[25] And the Division does not analyze these factors or explain why they show that Stitt acted as a broker-dealer. Moreover, even if receipt of commissions conclusively established Stitt's association with a broker, the Division does not demonstrate that this association occurred at the time of the misconduct for which Stitt was enjoined.[26]

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[22] *See McDuff*, 2015 WL 1873119, at *1 n.2 ("A person who acts as an unregistered broker-dealer is 'associated' with a broker dealer for the purposes of Section 15(b).").

[23] *See* 17 C.F.R. §§ 201.155(a), .220(f).

[24] *See Neogenix Oncology, Inc. v. Gordon*, 133 F. Supp. 3d 539, 559 (E.D.N.Y. 2015); *James S. Tagliaferri*, Exchange Act Release No. 80047, 2017 WL 632134, at *4 (Feb. 15, 2017); *see also* Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47,064, 47,077 n.168 (Aug. 4, 2010) (stating that because certain "intermediaries" received "transaction-based compensation," they "would need to register as broker-dealers under section 15 of the Exchange Act").

[25] *McDuff*, 2015 WL 1873119, at *2; *see SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011) ("an array of factors determines whether a person qualifies as a broker under Section 15(a)").

[26] In *McDuff*, the Commission remanded in similar circumstances, finding that an administrative law judge erred in determining that a respondent

(continued…)

And the third paragraph of the OIP likewise does not help the Division. That paragraph begins with the assertion that the Division alleged various facts in its injunctive complaint. It then proceeds to describe what it alleged in that complaint. In other words, if deemed true, the third paragraph of the OIP seemingly establishes only that the Division previously alleged other facts and does not actually establish the facts previously alleged in the injunctive complaint.

In its motion for sanctions by default, however, the Division argues that the first sentence in paragraph three—the sentence that reads "The Commission's complaint in the civil action alleges that Stitt committed a number of violations of the federal securities laws"—is "introductory" but "does not modify the" sentences that follow.[27] Normally, however, an *introductory* sentence is one that *introduces*. But even crediting the Division's argument—even assuming the first sentence does not declare that what follows are the allegations in the injunctive complaint but are instead an attempt to affirmatively assert factual allegations—the Division has at best shown that the third paragraph is ambiguous because it is subject to two interpretations. I do not believe this ambiguity in the OIP should redound to the Division's benefit.[28]

Given the foregoing, the Division has not met its burden, on the present record, as to whether Stitt was associated with a broker-dealer in the present or at the time of his misconduct.[29] The Division's motion is denied without prejudice as it relates to the second prerequisite.

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acted "as a broker or dealer at the time of his misconduct." 2015 WL 1873119, at *2.

[27] Mot. at 3 n.3.

[28] *Cf. Garcia v. Holder*, 584 F.3d 1288, 1290 (10th Cir. 2009) (ambiguity does not benefit a party bearing burden of proof); *Mashpee Tribe v. New Seabury Corp.*, 592 F.2d 575, 589 (1st Cir. 1979) ("normally the party asserting the affirmative of a proposition should bear the burden of proving that proposition"); *Bravado Int'l Grp. Merch. Servs., Inc. v. Ninna, Inc.*, 655 F. Supp. 2d 177, 186 (E.D.N.Y. 2009) (noting "the 'oft-stated preference for resolving disputes on the merits,'" and that "defaults are 'generally disfavored' and 'doubt should be resolved in favor of the defaulting party'").

[29] Stitt did not contest whether the Division met its burden on this issue. The 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 Stitt's failure to address this point. *Cf. Vermont Teddy Bear Co. v. 1-800 Beargram*

(continued…)

As to the public interest, I have taken notice that Stitt was enjoined from violating a number of securities provisions, including the antifraud provisions in Securities Act Section 17 and Exchange Act Section 10(b). And the Commission takes antifraud injunctions quite seriously.[30] Even so, the Commission and the courts have made clear that a bar does not automatically result from an injunction[31]—otherwise there would be no need for this proceeding—and an individual assessment of the public interest in each case is required.[32]

The problem here is that the record gives me little to work with. Other than showing the bare fact that Stitt was enjoined, the default injunction does not, by itself or in combination with the injunctive complaint, establish any facts on which I can rely.[33] And, as discussed, accepting the allegations in the OIP only establishes that Stitt was enjoined and at some unknown time "received undisclosed commissions" "[i]n exchange" for interests he sold in unregistered securities offerings.[34] The OIP establishes no other useful facts. The established facts are therefore not enough to assess the public interest.[35]

Co., 373 F.3d 241, 244 (2d Cir. 2004) ("failure to oppose a motion for summary judgment" is by itself not a basis to grant "summary judgment. Instead, the district court must still assess whether the moving party has fulfilled its burden of demonstrating that there is no genuine issue of material fact and its entitlement to judgment as a matter of law.").

[30] *See James C. Dawson*, Investment Advisers Act of 1940 Release No. 3057, 2010 WL 2886183, at *6 (July 23, 2010).

[31] *See McDuff*, 2015 WL 1873119, at *1–3 (involving a respondent permanently enjoined by default from violating Securities Act Sections 5(a), 5(c), and 17(a), Exchange Act Sections 10(b) and 15(a), and Exchange Act Rule 10b-5).

[32] *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 (2d Cir. 2005) (remarking on the Commission's failure to "devote individual attention to the unique facts and circumstances of [a] case").

[33] *See McDuff*, 2015 WL 1873119, at *1, *3; *Reinhard*, 2010 WL 421305, at *4 & nn.25–26.

[34] OIP ¶¶ II.A.1, II.B.2.

[35] *See McDuff*, 2015 WL 1873119, at *3.

The Division's motion is denied without prejudice as it relates to the public interest.

Order

I DENY the Division's motion without prejudice to renewal. If the Division renews its motion, it may submit a motion and additional evidence by December 7, 2018.

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James E. Grimes
Administrative Law Judge