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

Administrative Proceedings Rulings
Release No. 6636 / July 23, 2019

Administrative Proceeding
File No. 3-19145

In the Matter of

Matthew R. Rossi and
SJL Capital, LLC

Order on Cross Motions for Summary Disposition

This is a partially settled proceeding in which Respondents Matthew R. Rossi and SJL Capital, LLC, have conceded that they violated several antifraud provisions of the securities laws. The remaining issues are whether Respondents should be ordered to pay disgorgement, prejudgment interest, and civil penalties. Both sides have moved for summary disposition. For the reasons discussed below, the Division's motion is granted in part and denied in part. Respondents' motion is denied.

Background

The Securities and Exchange Commission initiated this proceeding in April 2019, when it issued an order instituting proceedings (OIP) in which it accepted Respondents' offer of settlement.[1] Under the terms of Respondents' agreement, the OIP conclusively provides that Respondents violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, subsections (1), (2), and (4) of Section 206 of the Investment Advisers Act of 1940, Exchange Act Rule 10b-5, and Advisers Act Rule 206(4)-8.[2] The OIP also provides for additional proceedings to resolve whether

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1 *See Matthew R. Rossi*, Securities Act of 1933 Release No. 10628, 2019 WL 1723740 (Apr. 17, 2019).

2 OIP at 8–9; *see* 15 U.S.C. §§ 77q(a), 78j(b), 80b-6(1), (2), (4); 17 C.F.R. §§ 240.10b-5, 275.206(4)-8.

Respondents should be ordered to pay disgorgement, prejudgment interest, and civil penalties.[3] In these additional proceedings, Respondents cannot contest that they violated the provisions noted above or the OIP's factual findings, which must be accepted as true.[4] Following issuance of the OIP, the parties moved for summary disposition. The Division has moved for summary disposition on disgorgement, civil monetary penalties, and whether I should credit Respondents' alleged inability to pay. Respondents have moved for summary disposition only as to inability to pay.

Discussion

Summary disposition standard

Commission Rule of Practice 250(c) governs the parties' motions for summary disposition.[5] A motion for summary disposition must demonstrate, based on "undisputed pleaded facts, declarations, affidavits, deposition transcripts, documentary evidence or facts officially noted[,] … 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."[6] When adjudicating a party's motion for summary disposition, I must construe the facts, whether established in the OIP or otherwise, "in the light most favorable to the" non-moving party.[7]

Established facts

Rossi was the founder, managing partner, and 80% majority owner of SJL.[8] SJL was the general partner of the MarketDNA Hedge Fund LP.[9] Respondents defrauded four fund investors who "lost at least $300,000."[10]

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3 OIP at 9.

4 *Id.*

5 *See* 17 C.F.R. § 201.250(c).

6 *Id.*

7 Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,224 n.112 (July 29, 2016).

8 OIP at 3.

9 *Id.*

10 OIP at 3–6.

Respondents also defrauded three other investors whose accounts they managed separately, outside the fund.[11] These latter three investors lost "over $1.5 million."[12]

Rossi made false representations to the separately managed account holders and failed to disclose the poor performance of their investments.[13] This allowed Rossi to obtain "fees to which he was not entitled and would not otherwise have obtained."[14] At Rossi's request, two of his separately managed clients pre-paid $28,935 in performance-based fees.[15] Rossi used these funds to pay (1) personal expenses, (2) a Fund investor, and (3) a family member.[16] He also used the pre-paid fees to engage in risky trading, eventually losing nearly $10,000.[17]

Disgorgement and interest

Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act permit the Commission to order disgorgement and reasonable interest in cease-and-desist proceedings.[18] Section 203(j) of the Advisers Act contains similar authority as to any proceeding under Section 203 in which a penalty may be imposed.[19] Disgorgement is an equitable, discretionary remedy, which is intended to prevent unjust enrichment and to act as a deterrent.[20] To

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11 OIP at 3, 6–8.

12 OIP at 3.

13 OIP at 6–8.

14 OIP at 8.

15 OIP at 8. The OIP states that Rossi received $28,965 in pre-paid fees, but the following paragraph details payments of $5,281, $4,446, and $19,208, a total of $28,935, which is the amount the Division cites in its motion. Div. Mot. at 11.

16 OIP at 8.

17 *Id.*

18 15 U.S.C. §§ 77h-1(e), 78u-3(e).

19 15 U.S.C. § 80b-3(j).

20 *See* 15 U.S.C. §§ 77h-1(e) (providing that the Commission "may" order disgorgement), 78u-3(e) (same); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989) ("Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from

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establish the appropriate amount of disgorgement, the Division need only show "a reasonable approximation of profits causally connected to the violation."[21]

Normally, once the Division makes the required showing, the burden shifts to the respondent to show "that the disgorgement figure was not a reasonable approximation."[22] In this case, however, the OIP conclusively establishes that Rossi received $28,935 in pre-paid performance fees.[23] Respondents do not dispute this figure or deny that Rossi's receipt of these fees is causally related to Respondents' misconduct. Respondents must therefore disgorge this amount plus prejudgment interest determined according to Rule 600 of the Rules of Practice.[24] Because all of Rossi's fees resulted from violations of Securities Act Section 17, Exchange Act Section 10(b), and Advisers Act Section 203, all of the payments he received are causally related to his conceded securities violations. All of the payments he received are therefore subject to disgorgement.[25]

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violating the securities laws."); *see also SEC v. Analytica Bio-Energy Corp.*, 317 F. Supp. 3d 574, 580 (D.D.C. 2018) (noting that the rationale for disgorgement was not changed by *Kokesh v. SEC*, 137 S. Ct. 1635 (2017)).

[21] *SEC v. Contorinis*, 743 F.3d 296, 305 (2d Cir. 2014); *First City Fin.*, 890 F.2d at 1231.

[22] *First City Fin.*, 890 F.2d at 1232.

[23] OIP at 8.

[24] 17 C.F.R. § 201.600. *See Terence Michael Coxon*, Exchange Act Release No. 48385, 2003 WL 21991359, at *14 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005). The Division has provided a prejudgment interest calculation—$3,285.72— through June 7, 2019. *See* Div. App. D. While I accept these calculations as accurate, because this order does not conclude this proceeding, this figure will be out of date by the time an initial decision is issued.

[25] *Cf. optionsXpress*, Exchange Act Release No. 78621, 2016 WL 4413227, at *36 (Aug. 18, 2016) (finding that commissions earned represented "an appropriate disgorgement amount"); *Maria T. Giesige*, Advisers Act Release No. 2886, 2009 WL 1507584, at *8 (May 29, 2009) ("Because Giesige received this money as compensation for the very transactions that constituted the

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The Division's motion is granted as to disgorgement and interest, subject to the Division providing an updated interest figure after the hearing.

Civil Penalties

This proceeding was instituted under six securities law provisions: Securities Act Section 8A, Exchange Act Section 21C, Advisers Act Section 203(e), (f), and (k), and Section 9(b) of the Investment Company Act of 1940.[26] For proceedings under three of these provisions, Investment Company Act Section 9(b) and Advisers Act Section 203(e) and (f), monetary penalties may only be imposed based on a determination that (1) penalties are in the public interest and (2) the respondent willfully violated provisions of or rules under the four securities statutes.[27] For proceedings under two of these provisions, Exchange Act Section 21C and Advisers Act Section 203(k), by contrast, the Commission may impose civil monetary penalties based simply on the determination that the respondent has violated any provision of or rule under the respective Act in question.[28] And for proceedings under Securities Act Section 8A, the Commission may impose civil monetary penalties if the respondent has violated any provision of or rule under the Securities Act and penalties are in the public interest.[29]

The upshot of this patchwork is that if the Division seeks the imposition of penalties without tying specific violations to particular statutes, it must meet the higher burden of showing willfulness and that penalties are in the public interest. And the Division has elected to do that, focusing only on Respondents' violation of Exchange Act Section 10(b) and Rule 10b-5.[30]

To guide the assessment of civil monetary penalties, the statutes under which this proceeding was instituted set out a three-tiered system, based on increasing degrees of culpability, for determining the maximum civil penalty for "each … act or omission" constituting a securities violation.[31] The statutes

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violations at issue, the disgorgement order is appropriate, whether or not Giesige is currently able to pay the full disgorgement amount.").

[26] OIP at 1.

[27] 15 U.S.C. §§ 80a-9(d)(1)(A), 80b-3(i)(1)(A).

[28] 15 U.S.C. §§ 78u-2(a)(2), 80b-3(i)(1)(B).

[29] 15 U.S.C. § 77h-1(g)(1).

[30] Div. Mot. at 15–17.

[31] *See* 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b), 80a-9(d)(2), 80b-3(i)(2).

do not define the precise unit of violation referenced in the phrase "each act or omission." For the time period at issue, the maximum first-, second-, and third-tier penalty for each violation of the Securities Act for a natural person is $8,671, $86,718 and $173,437, respectively, and for any other entity, $86,718, 433,591, and 838,275.[32] For the Exchange Act, Investment Company Act, and Advisers Act, the respective amounts for a natural person are $9,472, 94,713, and $189,427, and for any other entity, the respective figures are $94,713, $473,566, and $947,130.[33] First-tier penalties may be imposed based simply on the fact of a violation.[34] Second-tier penalties may be imposed if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.[35] And third-tier penalties may be imposed if the requirements for the second-tier are met and the violation resulted in either

> substantial losses or created a significant risk of substantial losses to other persons; or
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> substantial pecuniary gain to the person who committed the act or omission.[36]

Among other provisions, Respondents agreed that they violated Exchange Act Section 10(b), Advisers Act Section 206(1), and Exchange Act Rule 10b-5. Scienter is required to show a violation of each of these provisions.[37] Because scienter "refer[s] to 'a mental state embracing intent to deceive, manipulate, or defraud,'"[38] Respondents have necessarily conceded that the requirements

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[32] Adjustments to Civil Monetary Penalty Amounts, 84 Fed. Reg. 5122, 5123 (Feb. 20, 2019); *see* 17 C.F.R. § 201.1001, tbl.I.

[33] 84 Fed. Reg. at 5123–24.

[34] *See* 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b), 80a-9(d)(2), 80b-3(i)(2).

[35] *See* 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b), 80a-9(d)(2), 80b-3(i)(2).

[36] *See* 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b), 80a-9(d)(2), 80b-3(i)(2).

[37] *Dennis J. Malouf*, Advisers Act Release No. 4463, 2016 WL 4035575, at *7, *13 (July 27, 2016). Paragraph (1) under Securities Act Section 17(a) also requires a showing of scienter. *Id.* at *11. But the OIP does not specify whether Respondents violated all three paragraphs under Section 17(a) or merely one of them. *See* OIP at 8.

[38] *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, n.12 (1976)).

for second-tier penalties—conduct involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement—are met with respect to any conduct described in the OIP that represents a violation of any of these provisions.

Because Respondents' investors lost at least $1.8 million, their misconduct caused "substantial losses."[39] These threshold requirements for third-tier penalties—fraud, deceit, or manipulation plus substantial losses—are therefore met.

The Division, however, does not discuss how to assess the appropriate penalty or argue in favor of any particular amount. This is a problem because, as noted, the statutes do not define the unit of violation. Although penalties are sometimes assessed per bad act, penalties can also be assessed based on the determination that the misconduct at issue involved a single ongoing event for which a single penalty is appropriate. It is difficult to say that the Division is "entitled to summary disposition as a matter of law" on the question of penalties without knowing what the Division, *as the movant*, asserts is the appropriate unit of violation or penalty.

Further, the OIP gives Respondents the right to present testimony at a hearing.[40] Respondents have decided to exercise that right.[41] Assessing the public interest in advance of that testimony would be premature.

Finally, without knowing the amount of the civil monetary penalty, I also cannot conclude that the Division is entitled to summary disposition in its effort to prevent Rossi from relying on an alleged inability to pay.

Inability to pay

For their part, Respondents argue that they lack the ability to pay any disgorgement or civil monetary penalties.[42] By statute, a respondent subject to a possible civil monetary penalty may present evidence of his ability to pay the penalty and the Commission may, in its discretion, consider that evidence

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[39] *See David E. Lynch*, Exchange Act Release No. 46439, 2002 WL 1997953, at *4 (Aug. 30, 2002) (finding that a respondent whose fraud cost customers "at least $1.85 million," had caused substantial losses).

[40] OIP at 9.

[41] Prehearing Tr. 10.

[42] Resp'ts' Mot. at 1–2.

in assessing whether the public interest supports imposing a penalty.[43] The Commission has implemented these statutes in Rule of Practice 630, subsection (a) of which provides that "[t]he Commission may, in its discretion, or the hearing officer may, in his or her discretion, consider evidence concerning ability to pay in determining whether disgorgement, interest or a penalty is in the public interest."[44] Inability to pay "is only one factor that informs [the] determination" of penalties and disgorgement "and is not dispositive."[45] Respondents bear the burden to show inability to pay.[46]

The Commission has not provided specific guidance about how to evaluate whether a respondent has shown an inability to pay. It has however repeatedly held that it has the discretion not to waive disgorgement or penalties "when the [relevant] misconduct is *sufficiently* egregious."[47] Giving effect to this language means that a respondent whose misconduct is particularly unscrupulous will have difficulty when seeking to reduce his or her monetary liability based on an inability to pay. But if a respondent shows an inability to pay and his or her misconduct is less egregious, or not egregious at all, then an administrative law judge may exercise his or her discretion to reduce disgorgement or a penalty.

Consideration of inability to pay will thus require a two-part inquiry. First, an administrative law judge must determine whether the respondent has shown an inability to pay the imposed disgorgement and penalties. This necessarily involves a comparison of the amounts imposed against the respondent's income, assets, liabilities, and any respondent-specific factors that might bear on his or her ability to pay. If the respondent fails to show an inability to pay, the inquiry ends.

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[43] 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d), 80a-9(d)(4), 80b-3(i)(4).

[44] 17 C.F.R. § 201.630(a).

[45] *Thomas C. Bridge*, Securities Act Release No. 9068, 2009 WL 3100582, at *25 (Sept. 29, 2009), *pet. for review denied*, *Robles v. SEC*, 411 F. App'x 337 (D.C. Cir. 2010).

[46] *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *4 & nn. 29–30 (Oct. 27, 2006).

[47] *See Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *24 (Dec. 15, 2009) (emphasis added) (declining to reduce a penalty in light of the egregiousness of respondent's actions); *Lehman*, 2006 WL 3054584, at *4.

If the respondent shows an inability to pay, whether in whole or in part, the second step involves assessing whether to credit that inability. The Commission has not explained how to undertake this assessment but remembering the Commission's focus on the egregiousness of the misconduct involved, the assessment must involve weighing the seriousness or egregiousness of the violation in relation to the Commission's core mission of "'protecting investors[,] … safeguarding the integrity of the markets,'" and "making securities law violations unprofitable."[48] This is necessarily a fact-specific inquiry.

Considering the above, it is apparent that material facts remain at issue regarding Respondents' ability to pay. Although Respondents filed their motion jointly, they have only submitted evidence as to Rossi. And they have made no argument about the egregiousness of their misconduct. They have thus failed to carry their burden and are consequently not entitled to summary disposition as a matter of law.[49]

Respondents' motion is denied.

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James E. Grimes
Administrative Law Judge

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[48] *Gordon Brent Pierce*, Securities Act Release No. 9555, 2014 WL 896757, at *19 (Mar. 7, 2014) (quoting *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993)).

[49] To be clear, and for Respondents' benefit, this ruling means that they are not entitled to a ruling as a matter of law on their motion. They may present evidence and argument about their ability to pay at the hearing to be held in August 2019.