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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-13927

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In the Matter of

GORDON BRENT PIERCE, NEWPORT CAPITAL CORP., and JENIROB COMPANY LTD.,

Respondents.

DIVISION OF ENFORCEMENT'S BRIEF IN SUPPORT OF ITS CROSS-PETITION FOR REVIEW OF THE INITIAL DECISION AGAINST GORDON BRENT PIERCE

MARC J. FAGEL
MICHAEL S. DICKE
JOHN S. YUN
JUDITH L. ANDERSON
STEVEN D. BUCHHOLZ
44 Montgomery Street, Suite 2600
San Francisco, CA 94104
Tel: (415) 705-2500
Fax: (415) 705-2501
Attorneys for
DIVISION OF ENFORCEMENT

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

In the Initial Decision in this proceeding, the Hearing Officer properly held that unregistered sales of securities by stock promoter Respondent Gordon Brent Pierce ("Pierce") through the accounts of Newport Capital Corp. ("Newport") and Jenirob Company Ltd. ("Jenirob") violated Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and properly ordered Pierce to cease and desist from further Section 5 violations and to disgorge approximately $7.2 million in net profits. The Initial Decision also properly held that Pierce's res judicata defense did not bar the Division of Enforcement's ("Division") Section 5 claim against Pierce because his concealment of crucial evidence pertaining to the sales transactions and to his beneficial ownership of the Newport and Jenirob accounts prevented the Division from including this claim in an earlier administrative proceeding instituted against him in 2008.

While concurring with the result, to provide guidance in future cease-and-desist proceedings, the Division seeks review of the Initial Decision's erroneous holding that, but for Pierce's concealment, res judicata would have barred the Section 5 claim against Pierce. Examination of this holding is important because Pierce admitted the Section 5 violation in his Answer, but attempted to avoid liability by asserting as an affirmative defense the doctrine of res judicata, which is intended to preclude piecemeal litigation in courts of general jurisdiction.

In the earlier proceeding, the Division alleged, and the Hearing Officer held, that Pierce was liable for violating Section 5 by making unregistered sales of securities from his *personal* account at a Liechtenstein bank. In that proceeding, the Division received evidence from a foreign regulator of Pierce's unregistered sales through the Newport and Jenirob accounts at the same Liechtenstein bank over a month *after* the hearing had concluded. The Division immediately moved to admit the evidence and sought to adjudicate this separate Section 5

violation and additional disgorgement. Pierce objected on due process grounds, arguing that he was entitled to notice, an opportunity to respond and a new hearing. The Hearing Officer admitted the new evidence as it pertained to Pierce's liability for the claims alleged in the first proceeding, but held that a claim based on the Newport and Jenirob sales was beyond the scope of that proceeding. Despite his earlier position, Pierce now argues that res judicata bars the Division's Section 5 claim in this proceeding for his unregistered sales through Newport and Jenirob because the claim was, or could have been, litigated in the prior proceeding. A ruling that res judicata bars the present claim thus would have foreclosed any adjudication of this independent Section 5 violation and allowed Pierce to escape liability for an admitted wrong.

Specifically, the Initial Decision erred in several key respects. First, it incorrectly found that the Section 5 violations adjudicated in the prior and present proceedings arose from the same transactional facts involving the same "right to sanctions for violation of Section 5," when its analysis should have focused on the distinct Section 5 violations that were alleged in each proceeding. Second, while acknowledging that the Hearing Officer did not adjudicate the present Section 5 claim in the first proceeding, the Initial Decision incorrectly found that res judicata applied because the legality of the Newport and Jenirob sales at issue in the present administrative proceeding "could have been conveniently tried in the first proceeding." The Initial Decision further erred by finding that a final judgment had been entered on the merits against Pierce in the earlier proceeding for what it apparently viewed as an omnibus Section 5 violation, reasoning incorrectly that it was "irrelevant" that the judgment did not award "additional disgorgement" for the separate Newport and Jenirob violations.

The Initial Decision's res judicata holding also raises significant policy concerns. The availability of such a defense in similar contexts could give comfort to securities violators that

they could obtain procedural immunity from liability for independent violations as to which the staff had not obtained evidence by the time of an earlier proceeding, but later discovered.

II. ISSUES FOR REVIEW

A. Whether the Initial Decision erroneously determined that there was an identity of claims between the Section 5 violation alleged against Pierce in the prior administrative proceeding for his unregistered sales of Lexington stock through his personal account at a Liechtenstein bank and the separate Section 5 violation alleged against Pierce in the present proceeding for his unregistered sales of Lexington stock through the Newport and Jenirob accounts at the Liechtenstein bank.

B. Whether the Initial Decision erroneously held that a final judgment was rendered in the prior administrative proceeding that would bar adjudication of the Division's claim in the present proceeding for Pierce's violation of Section 5 by his unregistered sales of securities through the Newport and Jenirob accounts.

C. Whether the Initial Decision erroneously employed a res judicata analysis applicable to federal courts of general jurisdiction in holding that the present claim for Pierce's violation of Section 5 could have been conveniently tried as part of the prior administrative proceeding, if not for Pierce's concealment of evidence.

III. STANDARD OF REVIEW

The Commission's Rule of Practice 411(a) provides that in reviewing initial decisions of administrative hearing officers, the Commission may "make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). Pursuant to this rule, the Commission considers an appeal of the administrative law judge's initial decision on a *de novo* basis. *See* 5 U.S.C. § 557(b) (Administrative Procedures Act provision granting agency reviewing initial decision "all powers which it would have in making the initial decision except

as it may limit the issues on notice or by rule"); *Gross v. SEC*, 418 F.2d 103, 105, 107-108 (2d Cir. 1969) (applying § 557(b) & *de novo* standard to Commission appellate decision).

IV. PROCEDURAL BACKGROUND

On June 8, 2010, the Commission issued its Order Instituting Proceedings ("OIP"), pursuant to Section 8A of the Securities Act, against respondents Gordon Brent Pierce, Newport Capital Corp. and Jenirob Company Ltd.[1] Initial Decision ("ID") at 1; Buchholz Decl. II Ex. M. Pierce was a respondent in an earlier administrative proceeding, *Lexington Resources, Inc., et al.*, Administrative Proceeding File No. 3-13109 (the "First Proceeding"). ID at 1, Buchholz Decl. II Ex. A. The Initial Decision in that proceeding, issued on June 5, 2009 ("First Initial Decision" or "First ID"), found, among other things, that Pierce had violated Sections 5(a) and 5(c) of the Securities Act by his unregistered sales of the stock of Lexington Resources, Inc. ("Lexington") from his personal account at a Liechtenstein bank without an exemption from registration. Buchholz Decl. II Ex. J at 17. Neither party appealed that decision and it became the final decision of the Commission on July 8, 2009. ID at 8: Buchholz Decl. II Ex. K.

In the OIP in the present proceeding, the Division alleged that Pierce, Newport and Jenirob violated Sections 5(a) and 5(c) of the Securities Act by their sales of Lexington stock through accounts of Newport and Jenirob at a Liechtenstein bank without an exemption from registration. Pierce was the beneficial owner of those accounts. Buchholz Decl. II Ex. M. In an

[1] In addition to the Initial Decision's factual findings, the Division relies on evidence cited in the record below, including attachments thereto, as follows: Declarations of Jeffrey Lyttle and Steven Buchholz In Support Of The Division of Enforcement's Motion for Sanctions and Entry of Default Judgment Against Respondents Newport Capital Corp. and Jenirob Company, Ltd and Anticipated Motion for Summary Disposition Against Respondent Pierce (cited, respectively, as "Lyttle Decl." and "Buchholz Decl. I"); Declaration of Steven Buchholz in Further Support of the Division of Enforcement's Motion for Summary Disposition Against Respondent Pierce ("Buchholz Decl. II"); Declaration of Christopher Wells In Support Of Respondent Pierce's Motion For Summary Disposition ("Wells Decl."); Declaration of Steven Buchholz in Support of the Division of Enforcement's Opposition to Respondent Pierce's Motion for Summary Disposition ("Buchholz Decl. III").

Answer filed on July 9, 2010, Pierce admitted the facts indicating his liability for the Section 5 violations alleged by the Division and further admitted that he was the beneficial owner of the Newport and Jenirob accounts. Buchholz Decl. II Ex. U at 5. Pierce additionally raised a number of affirmative defenses, including that the Division's claims against him were barred by equitable and judicial estoppel, waiver and the doctrine of res judicata. *Id.* at 6.

At a November 19, 2010 prehearing conference, the parties consented to an initial decision based upon cross-motions for summary disposition. ID at 2 (Transcript of Nov. 19, 2010 prehearing conference, at 15:12-18:13). On March 22, 2011, the Division and Pierce each filed cross-motions for summary disposition. After the briefing was completed, the parties orally argued their motions before ALJ Cameron Elliot on June 8, 2011. At that hearing, the parties again consented to an initial decision based upon their motions for summary disposition without an evidentiary hearing. ID at 2, 3 & n.1 (Transcript of June 8, 2011 oral argument, at 3:22-6:22; 82:15-83:17). Thereafter, the parties filed post-argument briefs together with exhibits. ID at 2.

On July 27, 2011, ALJ Elliot issued the Initial Decision in the present proceeding against Pierce.[2] Applying preponderance of the evidence as the standard of proof under *Steadman v. SEC*, 450 U.S. 91, 101-04 (1981), the Initial Decision stated that the findings of fact were based largely on Pierce's admissions in his Answer to the OIP and on the Findings of Fact in the Initial Decision in the First Proceeding. ID at 3. As discussed in greater detail in Section V.H below, the Initial Decision found that Pierce had violated Sections 5(a) and 5(c) of the Securities Act, ID at 9-10, that Pierce's res judicata defense was inapplicable because of his concealment of evidence; and that his other affirmative defenses were also inapplicable. ID at 16-20.

[2] Earlier, on May 11, 2011, ALJ Elliot issued an Order Making Findings and Imposing Sanctions by Default as to the other two respondents in this proceeding, Newport and Jenirob.

Accordingly, ALJ Elliot issued a cease-and-desist order against Pierce and ordered him to disgorge a total of $7,427,635.75 plus prejudgment interest. ID at 20-22.

V. FACTUAL BACKGROUND

The Division relies primarily on the factual findings in the Initial Decision, which are summarized below and which Pierce has not contested. *See* ID at 3-9. The Division additionally relies upon certain other documents in the record below, including the Initial Decision in the First Proceeding, which Pierce did not appeal.

A. Gordon Brent Pierce, Newport and Jenirob

Pierce, age 54, is a Canadian citizen residing in Vancouver, British Columbia. ID at 3. Pierce was the beneficial owner of the assets in the accounts of respondents Newport and Jenirob at the Liechtenstein bank. *Id.* Newport was a privately held company organized under the laws of Belize and domiciled in Switzerland. ID at 4. Newport invested in public companies, helped them raise capital, provided investor relations services and aided companies in finding suitable acquisition opportunities. *Id.* Pierce was formerly the president and a director of Newport. *Id.* Newport had no employees, only consultants. *Id.* Jenirob was a privately held company organized under the laws of the British Virgin Islands. *Id.*

B. Lexington Resources

Lexington Resources, Inc. ("Lexington") is a Nevada corporation that was a public shell company known as Intergold Corp. until November 2003, when it entered into a reverse merger with a private company known as Lexington Oil and Gas LLC and changed its name to Lexington Resources. ID at 4. Lexington's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act from 2003 until June 4, 2009, when its registration was revoked. *Id.* From 2003 to 2007, Lexington stock was quoted on the over-the-

counter bulletin board under the symbol "LXRS." *Id.* In 2008, Lexington's only operating subsidiaries entered Chapter 7 bankruptcy. *Id.*

C. Pierce's Relationship With Lexington

From 2002 to 2007, Pierce provided Intergold and then Lexington with operating funds, stock promotion services and capital-raising services through at least three different consulting companies that Pierce controlled, including Newport. Pierce used these consulting companies to conceal his role and avoid being identified by name in Commission filings. ID at 5. Lexington had neither full time employees nor offices of its own. *Id.* Instead, Lexington employed one of Pierce's consulting companies, International Market Trend AG ("IMT"), to provide administrative support and various other services. *Id.* Pierce's consulting companies were at times compensated for their services in stock or stock options in Lexington or Intergold. *Id.* In the First Proceeding, ALJ Foelak found that Pierce controlled Lexington and that, as of February 2, 2004, Pierce had a 23.9% interest in Lexington. Buchholz Decl. II Ex. J at 14, 17.

D. Issuance Of Lexington Shares To Pierce And His Associates

Beginning in October 2003 and continuing over the next several months, Lexington shares were distributed through a series of transactions to various individuals and entities, including Pierce, Newport and Jenirob. ID at 5. Pierce, Newport and Jenirob received shares pursuant to two different stock option plan agreements between Lexington and IMT. Buchholz I Decl. ¶ 2 and Ex. A; ¶ 19 and Ex. R. The option exercise agreements signed by Pierce provided that all shares were to be acquired for investment purposes only and with no view to resale or other distribution. ID at 6. On January 26, 2004, Lexington effectuated a three-for-one stock split. ID at 5.

Lexington filed three different registration statements on Form S-8 purporting to cover

issuances of Lexington shares to Pierce and others. Buchholz Decl. I ¶ 3 & Ex. B; ¶ 20 & Ex. S; ¶ 27 & Ex. Z; *see also* Lyttle Decl. ¶ 3. None of these registration statements contained a reoffering prospectus or covered subsequent resales of Lexington stock by Pierce, Newport, or Jenirob. *See* ID at 6; Buchholz Decl. I Exs. B, S, and Z.

E. Promotional Campaign Touting Lexington Stock

In late February 2004, Pierce began actively promoting Lexington stock by sending millions of spam emails and newsletters through a publishing company that Pierce controlled. ID at 6. At the same time, Lexington issued a flurry of optimistic press releases about its current and potential operations. Between February and June 2004, Lexington's stock price increased from $3.00 to $7.50, and its average trading volume increased from 1,000 to about 100,000 shares per day, reaching a peak of more than 1 million shares per day in late June 2004. *Id.*

F. Sales Of Lexington Shares By Pierce, Newport And Jenirob

Pierce sold approximately 1.6 million Lexington shares to the public through the Newport and Jenirob accounts at the Liechtenstein bank between February and December 2004. *Id.* at 6. The Newport account realized gains of $5,264,466.64 from its sales or deliveries of 1,308,400 Lexington shares between February 20, 2004 and September 29, 2004. *Id.* at 6. The Jenirob account realized gains of $1,983,169.11 from its sales or deliveries of 435,000 Lexington shares in June 2004. *Id.* at 6-7. In addition, and as adjudicated in the First Proceeding, Pierce sold 300,000 Lexington shares through his personal account at the bank in Liechtenstein in June 2004 for net proceeds of approximately $2 million.[3] *Id.* at 6. No registration statements were

[3] The 300,000 Lexington shares that Pierce sold through his personal account in Liechtenstein (at issue in the First Proceeding) were originally issued under the IMT option agreement dated November 18, 2003. Buchholz Decl. II Ex. J at 13. The 1.6 million Lexington shares that Pierce sold through the Newport and Jenirob accounts in Liechtenstein (at issue in the present proceeding) were issued in part under the November 2003 option agreement and in part under

filed relating to resales of Lexington stock by Pierce, Newport or Jenirob. ID at 6.

G. The First Proceeding Against Pierce And Others

The Division initiated its formal investigation into potential securities violations relating to Lexington on May 4, 2006. ID at 7 (citing Wells Decl. Ex. 1). As part of its investigation, the Division took Pierce's sworn testimony on July 27-28, 2006. *Id.* In that testimony, Pierce denied having an ownership stake of any kind, either directly or indirectly, in Newport, but admitted he had an unspecified interest in Newport's account at the Liechtenstein bank. *Id.* Pierce denied that he had an interest in Jenirob's account at the Liechtenstein bank and denied trading in Lexington securities in any U.S. account on behalf of Jenirob. *Id.*

The Division issued a document subpoena to Pierce on May 17, 2006. Buchholz Decl. III Ex. B. After issuance of the subpoena, Pierce belatedly filed and produced a Schedule 13D dated July 25, 2006, which states that he and Newport were beneficial owners of a number of Lexington shares in 2003-2004, but omits any reference to Jenirob's ownership of Lexington stock during the same time period. ID at 7. Although the subpoena required Pierce to produce statements from all accounts in which he had a beneficial interest and all documents reflecting transactions by him or any person or entity acting on his behalf in Lexington stock, Pierce produced only records pertaining to his personal account at the Liechtenstein bank plus the Schedule 13D. *Id.* He otherwise failed to produce, or objected to producing, account records or other documents pertaining to his Lexington stock sales through Newport and Jenirob. *Id.*

In late 2006, because the Division had obtained brokerage records showing that millions of Lexington shares were sold into the public market in 2004 through a U.S. brokerage firm via an omnibus account in the name of the Liechtenstein bank, the Division requested relevant

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the February 2004 option agreement. *See* Buchholz Decl. I ¶¶ 3-6 and Exs. B-E, ¶¶ 8-9 & Exs. G-H, ¶¶ 20-22 and Exs. S-U, ¶¶ 27-31 and Exs. Z-DD.

records of the bank through a diplomatic request to the Liechtenstein securities regulator, the Finanzmarktaufsicht (FMA). *Id.* Initially, the FMA did not produce any documents. *Id.* After learning that the FMA was working to amend Liechtenstein law and might be able to produce the documents, the Division renewed its request in February 2008. *Id.* The Division later learned that Pierce had filed an appeal objecting to production of records to the Division. *Id.* at 8.

On July 31, 2008, the Commission issued an Order Instituting Cease-And-Desist Proceedings ("First OIP"). *Id.* at 7; Buchholz Decl. II Ex. A. The First OIP charged Pierce, Lexington, and Lexington's CEO with violations of Sections 5(a) and 5(c) of the Securities Act in connection with unregistered sales of Lexington stock, citing Pierce's personal sales through an offshore bank in June 2004 without registration. ID at 7 (citing First OIP at ¶ 16). The First OIP additionally charged Pierce with violations of Sections 13(d) and 16(a) of the Securities Exchange Act of 1934. ID at 7. The relief sought included a cease-and-desist order and disgorgement. *Id.* The Division later clarified in its motion for summary disposition that it was seeking only disgorgement of the net proceeds of Pierce's unregistered sales through his personal account. ID at 8. These sales were the basis for the Section 5 violation alleged against Pierce in the First OIP. Buchholz Decl. II Ex. J at 15; *see* Wells Decl. Ex. 3 at 10-12. A hearing was held in the First Proceeding between February 2-4, 2009 before ALJ Carol Fox Foelak. *Id.* Although Pierce listed himself as a witness, he failed to appear at the hearing. *Id.*

Over a month after the hearing, on March 10, 2009, the FMA produced a number of documents to the Division. *Id.* The production included documents showing that accounts at the Liechtenstein bank in the names of Newport and Jenirob (in addition to other accounts, including Pierce's personal account) had sold Lexington stock into the public market during 2004 and that Pierce was the beneficial owner of the assets in the Newport and Jenirob accounts. *Id.* Until that

production, the Division did not have evidence showing which specific accounts made these unregistered sales, including the sale dates and the volume of shares sold on each date, nor did it know of Pierce's beneficial ownership of the Newport and Jenirob account assets. Division's Post-Argument Brief at 9-10; Buchholz Decl. III, ¶¶ 8-9.

Although the hearing had concluded over a month earlier, the Division nonetheless immediately moved for admission of the Liechtenstein documents, arguing that Pierce should be liable for a larger amount of disgorgement than the $2 million previously requested in connection with Pierce's sales from his personal account. ID at 8; *see also* Wells Decl. Ex. 12 (Division's Post-Hearing Brief). In opposition, Pierce argued that admission of the new evidence would result in surprise and prejudice. ID at 13 (citing Buchholz Decl. III, Ex. J, in which Pierce argued that admission of the documents would violate his due process rights).

While not discussed in the Initial Decision in the present proceeding, the record below includes the Division's Post-Hearing Brief in the First Proceeding, which was filed on March 20, 2009, just two days after the Division's motion to admit new evidence and before issuance of the ruling on that motion. *See* Wells Decl. Ex. 12. There, the Division argued that, in addition to Pierce's violation of Section 5 for the unregistered sales of 300,000 shares of Lexington stock from his personal account, Pierce violated Section 5 by his unregistered sales of 1.6 million shares of Lexington stock through the Newport and Jenirob accounts. *Id.* at 17. The Division therefore requested disgorgement not only of the approximately $2 million in net proceeds of Pierce's unregistered sales through his personal Liechtenstein account, but also of the net proceeds of his sales through the Newport and Jenirob accounts. *Id.* at 24-25.

The First Initial Decision, issued June 5, 2009, found that Pierce violated Sections 5(a) and 5(c) of the Securities Act and Sections 13(d) and 16(a) of the Exchange Act. ID at 8 (citing

First ID). Specifically, the First Initial Decision analyzed Pierce's violation of Section 5 in connection with the sales of Lexington stock from his personal account. Buchholz Decl. II, Ex. J at 15. Pierce was ordered to cease and desist such violations and to disgorge $2,043,362.33, which the decision described as "the actual profits Pierce obtained from his wrongdoing charged in the OIP." ID at 8; Buchholz Decl. II, Ex. J at 20. The First Initial Decision ruled, however, that the Division's request for additional disgorgement for the Newport and Jenirob sales was beyond the scope of the First OIP. ID at 8; Buchholz Dec. II, Ex. J at 20-21.

H. The Initial Decision Against Pierce In The Present Proceeding

As discussed above, the Initial Decision in the present proceeding found that Pierce violated Sections 5(a) and 5(c) of the Securities Act in connection with his Lexington stock sales through the Newport and Jenirob accounts. ID at 9-10. Ruling on Pierce's affirmative defenses, the Initial Decision determined that Pierce's equitable and judicial estoppel and waiver defenses were inapplicable, but found that all three elements of the res judicata test were met and that, "in the absence of any additional considerations, res judicata would bar the present proceeding." ID at 10-13, 16 (citation omitted). The Initial Decision held, however, that re judicata did not apply because Pierce had "fraudulently concealed" evidence concerning the Newport and Jenirob sales from the Division before the First Proceeding was instituted. ID at 18-20.

On August 16, 2011, Respondent filed his petition for review of the Initial Decision. The Division filed a cross-petition for review on August 24, 2011.

VI. LEGAL ARGUMENT

A. The Legal Framework For Analyzing A Res Judicata Defense

Res judicata is a judicially created doctrine that generally provides that "a final judgment on the merits in one action bars subsequent relitigation of the same claim by the same parties and by those in privity with the parties." *Greenberg v. Board of Governors of the Fed. Reserve Sys.*,

968 F.2d 164, 168 (2d Cir. 1992). The doctrine precludes parties from relitigating issues that were or could have been raised in the prior action. *Allen v. McCurry*, 449 U.S. 90, 94 (1980). Although the doctrine is intended to promote judicial economy and minimize the possibility of inconsistent decisions, *Montana v. United States*, 440 U.S. 147, 154-55 (1979), res judicata can also "shield the fraud and the cheat as well as the honest person" and "is to be invoked only after careful inquiry," *Brown v. Felsen*, 442 U.S. 127, 131-32 (1979); *accord Latman v. Burdette*, 366 F.3d 774, 784 (9th Cir. 2004) (improper application could reward the dishonest debtor).

In administrative proceedings before the Commission, a purported res judicata defense must be asserted in the respondent's answer as an affirmative defense. SEC Rule of Practice 202(c). To establish a res judicata affirmative defense, the respondent must satisfy a three-part test; the earlier suit must have "(1) involved the same claim or cause of action as the later suit, (2) reached a final judgment on the merits, and (3) involved identical parties or privies."[4] *Mpoyo v. Litton Electro-Optical Sys.*, 430 F.3d 985, 987 (9th Cir. 2005). Res judicata does not apply when fraud, concealment or misrepresentation "caused the plaintiff to fail to include a claim in a former action." *Harnett v. Billman*, 800 F.2d 1308, 1313 (4th Cir. 1986); *Doe v. Allied Signal, Inc.*, 985 F.2d 908, 910-11, 914 (7th Cir. 1993); *Montgomery v. NLR Co.*, 2007 U.S. Dist. LEXIS 82105 (D. Vt. Nov. 2, 2007) at *8-10.

The Initial Decision correctly rejected Pierce's res judicata defense on the ground that his concealment of evidence of the Newport and Jenirob sales prevented the Division from including a Section 5 claim for those sales in the First Proceeding. ID at 16-20. On that basis, the Initial Decision's liability determination and imposition of remedies may be affirmed by the

[4] The third res judicata element, identity of parties or privies, is not at issue on this appeal.

Commission. The Initial Decision's holding that, but for concealment, res judicata would have applied is based on a flawed legal analysis that should now be corrected, as discussed below.

B. The Initial Decision Erroneously Determined That There Was An Identity Of Claims In The Prior And Present Proceedings

1. The Legal Standard Applied By The Initial Decision To Analyze Identity Of Claims For Res Judicata Purposes

The Initial Decision applied a four-part test to analyze whether there was an identity of claims for purposes of res judicata: (1) whether rights or interests established in the prior judgment would be destroyed or impaired by prosecution of the second action; (2) whether the two suits involve infringement of the same right; (3) whether substantially the same evidence is presented in the two actions; and (4) whether the two suits arise from the same transactional nucleus of (operative) facts. *See* ID at 15-16 (citing *Mpoyo,* 430 F.3d at 987).

Under the *Mpoyo* test, whether the two suits share a common transactional nucleus of operative facts "controls and is intended to assure the two suits involve the same claim or cause of action." ID at 15-16 (citing *Mpoyo,* 430 F.3d at 988). To analyze this criterion, the Initial Decision considered two factors: "whether [the two suits] are related to the same set of facts and whether they could conveniently be tried together." *See Mpoyo*, 430 F.3d at 987. This latter criterion addresses the res judicata policy barring relitigation of claims that could have been litigated in an earlier proceeding. Cases generally have found that this criterion has been met when the operative transactions are the same and the plaintiffs could have raised the second claims in the first suit, but did not do so. *See, e.g., International Union of Operating Eng'rs-Employers Constr. Indus. Pension, Welfare and Training Trust Funds v. Karr*, 994 F.2d 1426, 1430 (9th Cir. 1993) (claims formed a convenient trial unit when plaintiffs had opportunity to bring them in same action); *see also Mpoyo* at 988 (both claims arose from "single act of termination stemming from a course of employment"); *Western Sys., Inc. v. Ulloa*, 958 F.2d 864,

871-72 (9th Cir. 1992) (both cases concerned rights to repurchase shares in same company arising from same agreements and factual circumstances).

Yet, merely because "several operative facts may be common to successive actions between the same parties does not mean that the claim asserted in the second is the same claim that was litigated in the first." *NLRB v. United Technologies Corp.*, 706 F.2d 1254, 1259-60 (2d Cir. 1983). Critically, res judicata preclusion is limited "to the transaction at issue in the first action. Litigation over other transactions, though involving the same parties and similar facts and legal issues, is not precluded" by res judicata. *Greenberg*, 968 F.2d at 168; *accord Computer Assoc. Int'l, Inc. v. Altai*, 126 F.3d 365, 369 (2d Cir. 1997). A first judgment will generally have preclusive effect where the transaction at issue in both suits is the same, that is "where the same evidence is needed to support both claims and where the facts essential to the second were present in the first." *SEC v. First Jersey Secs.*, 101 F.3d 1450, 1463-64 (2d Cir. 1996); *accord Computer Assoc.*, 126 F.3d at 369; *see Shamrock Assoc. v. Sloane*, 738 F. Supp. 109, 116 (S.D.N.Y. 1990); *see also Harris v. Jacobs*, 621 F.2d 341, 344 (9th Cir. 1980) (res judicata inapplicable where relevant evidentiary facts differ, even though both actions relate to incarcerated plaintiff's access to medical care).

In *Greenberg*, for example, the defendants asserted a res judicata defense to a decision by bank regulators barring them from the banking industry. The Second Circuit rejected this defense on the ground that none of the prior enforcement actions against the defendants concerned the same violative transactions that were at issue in the action under review. *Greenberg*, 968 F.2d at 168-170. Similarly, in *Shamrock*, the two suits arose out of Shamrock's acquisition of a company via a stock purchase agreement. The court held that the distinct acts of fraud in the two suits were not identical simply because they were in connection with some of

the same stock purchases inasmuch as the actions were founded on allegations of different facts and types of conduct by defendants and different effects of defendants' acts. *Id.* at 117. This principle applies regardless of whether the transactions were close in time, as in *Greenberg* and *Shamrock*, or occurred in successive time periods, *see, e.g.*, *SEC v. First Jersey Secs.*, 101 F.3d at 1463-64; *United Technologies Corp.*, 706 F.2d at 1259-60.

2. Analysis of Whether There Was An Identity Of Claims For Res Judicata Purposes Must Take Into Account That Separate And Distinct Section 5 Violations Were Alleged In Each Proceeding

Analyzing the *Mpoyo* factors, the Initial Decision erroneously held that, absent concealment, res judicata would apply because in each proceeding against Pierce, "the evidence is substantially the same, the facts are closely related, and the issue of the legality of the Newport and Jenirob sales could have conveniently been tried in the first proceeding." ID at 16-20 (citing *Mpoyo*, 430 F.3d at 987). This analysis fails to take into account the distinct violations alleged within the context of these administrative proceedings.

The administrative proceedings against Pierce were instituted under Section 8A of the Securities Act, which authorizes the Commission to issue a cease-and-desist order upon finding "that any person *is violating, has violated, or is about to violate* any provision of this title, or any rule or regulation thereunder." 15 U.S.C. § 77h-1(a) (emphasis added); *see* Buchholz Decl. II Exs. A, M. The matters to be decided in a cease-and-desist proceeding under Section 8A are limited to the "violations" alleged against the respondent by the order instituting proceedings. As a result, analysis of a res judicata defense in a cease-and-desist proceeding must look first to the violations that were actually decided against the respondent in the first proceeding.

Here, the two proceedings alleged separate violations of Section 5 of the Securities Act by Pierce. A *prima facie* case for a violation of Section 5 is established by showing that (1) no registration statement was in effect or filed as to the sale or offering of securities; (2) a person

directly or indirectly sold or offered to sell the securities; and (3) the sale was made through the use of interstate facilities or the mails. *See SEC v. Continental Tobacco Co.*, 463 F.2d 137, 155 (5th Cir. 1972). Determining whether a Section 5 violation exists depends upon an analysis of each specific transaction for the offer or sale of a security because Section 5 of the Securities Act requires that each particular offer or sale of shares must be registered or subject to an exemption. *See, e.g., SEC v. Cavanagh*, 155 F.3d 129, 133 (2d Cir. 1998); *Allison v. Ticor Title Ins. Co.*, 907 F.2d 645, 648 (7th Cir. 1990). SEC Interpretive Release No. 33-6188 (the "1980 Release"), which discusses the availability of the Form S-8 registration statement for stock issuances to employees of the issuer, states: "Section 5 provides that *every offer or sale of a security* made through the use of the mails or interstate commerce *must be accomplished through the use of a registration statement* meeting the Act's disclosure requirements, unless one of the several exemptions from registration set out in sections 3 and 4 of the Act is available."[5] 45 Fed. Reg. 8960, 8962 (Feb. 11, 1980) (emphasis added). The 1980 Release also provides that affiliates of the issuer must separately register their resales of S-8 shares.[6] *Id.* at 8976-77.

In the First Proceeding, the Division alleged that Pierce violated Section 5 of the Securities Act by selling Lexington shares from his personal account at the Liechtenstein bank into the public market without registration. *See* Buchholz Decl. II Ex. A (OIP) at ¶ 16. To

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[5] For example, Section 4(1) of the Securities Act provides an exemption from registration for sellers who are not underwriters, issuers or dealers. A control person of the issuer is considered an affiliate of the issuer and is treated as an issuer for the purposes of Section 4(1). *See SEC v. Cavanagh*, 155 F.3d at 134.

[6] The Form S-8 instructions specifically "advise all potential registrants that the registration statement does not apply to resales of the securities previously sold pursuant to the registration statement." Form S-8 General Instruction C.1 & n.2. Liability under Section 5 "is not confined only to the person who passes title to the security" but includes "persons other than sellers who are responsible for the distribution of unregistered securities." *SEC v. Murphy*, 626 F.2d 633, 649 (9th Cir. 1980).

establish Pierce's Section 5 violation in the first proceeding, the Division presented evidence showing that Pierce sold 300,000 shares of Lexington stock from his personal account at the Liechtenstein bank in June 2004, that no registration statement was filed or in effect as to his personal sales of those 300,000 shares, that Pierce directed those sales, and that those sales were made through interstate commerce. *See* Buchholz Decl. II Ex. J (Initial Decision) at 15; *see also id.* Ex. B (Division's Motion for Summary Disposition in First Proceeding) at 4. Based upon this evidence, ALJ Foelak found that the Division had presented a *prima facie* case against Pierce "for the sales from his personal account of Lexington stock that he acquired from the First S-8." Buchholz Dec. II Ex. J (Initial Decision) at 15. Finding that no exemption from registration applied as Pierce was an affiliate of Lexington, ALJ Foelak ruled that Pierce had violated Section 5 and ordered disgorgement of $2,077,969, finding that this amount represented the "actual profits Pierce obtained from his wrongdoing charged in the OIP." *Id.* at 20.

By comparison, the Division alleges in this proceeding that Pierce violated Section 5 by directing the sales of 1.6 million (different) Lexington shares through the Newport and Jenirob accounts at the Liechtenstein bank in 2004, that Pierce was the beneficial owner of the Newport and Jenirob accounts, that no registration statement was filed or in effect as to Pierce's sales of those shares and that the sales were made through interstate commerce. *See* Buchholz Decl. II Ex. M (OIP). The present OIP clearly distinguishes these sales of 1.6 million Lexington shares through Newport and Jenirob from the unregistered sales of 300,000 Lexington shares that Pierce made from his personal account. *See* Buchholz Decl. II Ex. M at ¶¶ 23, 25. Pierce admitted all of the foregoing facts in his Answer to the OIP. *See* Buchholz Decl. II Ex. U at 5. The Division further submitted evidence identifying the specific unregistered sales that together constitute the 1.6 million Lexington shares Pierce sold through the Newport and Jenirob accounts between

February and September 2004, and calculated that the net proceeds received from those sales was $7,247,635.75. *See* Division's Motion for Summary Disposition at 25 (citing Lyttle Decl. ¶¶ 3-24 and Exs. A-B; Buchholz Decl. I ¶¶ 2-35 and Exs. A-GG). The Initial Decision correctly concluded that the Division had stated a *prima facie* case against Pierce for violation of Section 5 in connection with the Newport and Jenirob sales. ID at 10.

Comparing the allegations and evidence submitted regarding the Section 5 claims in the two proceedings makes clear that ***none*** of the unregistered sales of 1.6 million shares that Pierce made through the Newport and Jenirob accounts were the same as the unregistered sales of 300,000 shares that Pierce made through his personal account. The complete absence of any overlap between the unregistered sales of 300,000 Lexington shares by Pierce in the first proceeding and of 1.6 million shares by Newport and Jenirob in this proceeding conclusively establishes that the Section 5 violations at issue in each proceeding were not the same. On this ground alone, the Initial Decision's conclusion that res judicata could have barred adjudication of Pierce's Section 5 violations was legally erroneous.

3. The Initial Decision Erred Because The Core Operative Facts Of The Section 5 Violations Differed In The First And Present Proceedings

The Initial Decision cited factual similarities between the first and second proceedings in determining that the evidence was the same and that the operative facts of the claims were closely related. ID at 16. The facts cited by the Initial Decision included that shares of the same company – Lexington – were sold through the same U.S. brokerage; that the same person – Pierce – controlled the stock sales; and that the transfers and sales occurred in the same time frame (2003-2004).[7] *Id.*

[7] The Initial Decision acknowledged that some of the facts were not necessary to prove the Division's *prima facie* Section 5 claim in the First Proceeding, but stated that it was citing them

The Initial Decision failed to recognize that it is the transactional nucleus of operative facts that controls. The mere commonality of other facts -- for example, the identity of the brokerage -- is not sufficient to establish the identity of the claims. *See, e.g., United Technologies,* 706 F.2d at 1259-60; *Greenberg*, 968 F.2d at 168. The Initial Decision also failed to consider that Section 5 is transaction specific and that each separate unregistered offer or sale constitutes a distinct violation of Section 5 absent an applicable exemption.

In fact, the core operative transactional facts of the Section 5 claims at issue – Pierce's unregistered sales of Lexington stock -- differed in each proceeding, as discussed in Section VI.B.2 above. The nucleus of operative facts pertaining to the Division's Section 5 claim in this proceeding consists of the specific unregistered sales transactions by which Pierce sold 1.6 million Lexington shares into the public market through the Newport and Jenirob accounts. In contrast, the nucleus of operative facts pertaining to the Division's Section 5 claim in the First Proceeding consisted of the specific unregistered sales transactions by which Pierce sold 300,000 Lexington shares into the public market through his personal account. Accordingly, there is no identity of claims between the two proceedings and res judicata does not apply.

4. The Initial Decision Erroneously Found That The Present Section 5 Claim Could Have Been Litigated In The First Proceeding

Based upon its holding that the transactional facts and evidence underlying the claims in each proceeding were substantially the same, the Initial Decision erroneously concluded that the present Section 5 claim could have been litigated in the First Proceeding. ID at 16. The Initial Decision improperly failed to take into account that two crucial facts supporting the Section 5 violation in this proceeding were not even known to the Division when the First Proceeding was

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because they "bore on the Exchange Act violations and on Pierce's defense that he was entitled to an exemption from registration." ID at 16.

instituted or by the time of the evidentiary hearing in that matter: (1) the fact that the specific, distinct unregistered sales transactions into the public market were made through the Newport and Jenirob accounts in Liechtenstein; and (2) the fact that Pierce made the sales through the Newport and Jenirob accounts and was the beneficial owner of the assets in the accounts.

As described above, the Division first obtained evidence of the specific unregistered sales transactions through the Newport and Jenirob accounts a month after the evidentiary hearing in the First Proceeding when it received the pertinent documents from the Liechtenstein regulator. Div. Post-Arg. Br. at 9-10; Buchholz Decl. III, ¶ 8. Before the new evidence was received, the Division only had evidence showing that large quantities of Lexington shares had been sold into the public market through an omnibus account in the name of the Liechtenstein bank. Other than the sales from Pierce's personal account, for which he produced records in 2006, the Division did not have evidence of the specific accounts at the Liechtenstein bank that made the unregistered sales into the public market, or who was the beneficial owner of those selling accounts. Without evidence of the specific selling accounts and their beneficial owners, the Division could not determine whether the sellers were underwriters or affiliates of the issuer, or if they arguably qualified for an exemption from registration.[8] *See* Buchholz Decl. II ¶¶ 8-9.

The Division immediately moved to admit the new evidence and the Division's post-hearing brief requested adjudication of the newly-discovered Section 5 violations. Wells Decl. Ex. 10, Ex. 12 at 17, 25. Pierce argued, in opposing admission of the new evidence, that expanding the scope of the Section 5 claim "denied his due process rights to notice of the claims" and denied him a reasonable opportunity to respond and an evidentiary hearing. Buchholz Decl. II Ex. G at 2. ALJ Foelak admitted the new evidence as it pertained to Pierce's

[8] For this reason, the Division could not have established Newport's liability in the First Proceeding, contrary to the conjecture by the Initial Decision. See ID at 19.

liability for the claims alleged in the First OIP, but did not adjudicate a Section 5 claim for the Newport and Jenirob sales, ruling that disgorgement of the proceeds obtained from these sales would be outside the scope of the First Proceeding. First ID at 20; Buchholz Decl. II Ex. I.

The fact that the new evidence was not received until a month after the evidentiary hearing, Pierce's argument that expanding the scope of the Section 5 claim would have required an additional evidentiary hearing, and ALJ Foelak's explicit holding that relief for the newly-discovered Section 5 violations would be outside the scope of the matters set down for hearing in the First Proceeding all demonstrate that the Section 5 violations in the present proceeding could not have been adjudicated in the First Proceeding. Indeed, because the evidence of the operative facts supporting the present Section 5 claim had not been produced at the time of the evidentiary hearing in the First Proceeding, the present proceeding provides Pierce with the due process he requested, including the opportunity for a full evidentiary hearing on that claim.

The Initial Decision may also have reached its conclusion that the present Section 5 claim against Pierce could have been litigated in the First Proceeding because ALJ Foelak admitted the new evidence of the Newport and Jenirob sales "for purposes of liability" in the First Proceeding. *See* Buchholz Decl. II Ex. I at 2. This analysis, too, would be incorrect. In the First Initial Decision, ALJ Foelak used the Newport and Jenirob evidence as further support for her rejection of Pierce's *affirmative defense* that he was entitled to an exemption from registration of the sales from his personal account. Pierce had the burden of proof on this defense. *SEC v. Ralston Purina*, 346 U.S. 119, 126 (1953); *Swenson v. Engelstad*, 626 F.2d 421, 425 (5th Cir. 1980). ALJ Foelak cited the evidence to support her finding that Pierce was an affiliate of Lexington and therefore not entitled to an exemption from registration, as well as to support her holding that Pierce was liable for the Exchange Act violations. Buchholz Decl. II Ex. J (First ID) at 15-

18. It is beyond question that she did *not* use the Newport and Jenirob evidence to adjudicate Pierce's Section 5 violations for the unregistered sales through those accounts and attendant disgorgement, as she ruled that the new claims were outside the scope of the First Proceeding and that she had no authority to expand the scope of the First OIP. *Id.* at 20-21.

5. The Initial Decision Erroneously Employed A "Same Right" Analysis In Finding An Identity Of Claims

In finding an identity of claims between the two proceedings, the Initial Decision further erred by applying a "same rights" analysis. The Initial Decision found that "the two proceedings involve the same right – the right to sanctions for violation of Section 5 of the Securities Act – with the same requested form of relief – disgorgement and a cease-and-desist order." In support, the Initial Decision cited *International Union*, 994 F.2d at 1429, stating that there the court "found that the second element weighed in favor of application of res judicata because the right under a contract to have pension contributions 'accurately computed and timely paid' constituted a single right, as opposed to two different rights, one to accurate payments and another to timely payments." ID at 15. Based upon this case, the Initial Decision found that the "the right to be vindicated [in the present proceeding] is even more similar to the one in the first proceeding than the two allegedly different rights in *International Union*. That the specific amount of disgorgement, the specific sales transactions, and the specific 'alter-ego' corporations involved are different is not a sufficient distinction" to avoid res judicata. *Id.*

This "rights" based analysis is incorrect for two reasons. First, it overlooks the statutory purpose of these administrative proceedings, which is not to obtain "relief" under a contract as in *International Union*, but to determine whether there is evidence that the respondent violated the federal securities laws and, if so, to ascertain the appropriate sanctions for the violation. Section 8A(e) authorizes the Commission to "enter an order requiring accounting and disgorgement,

including reasonable interest." 15 U.S.C. § 77h-1(e). Disgorgement is a remedy "designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable." *SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1191-92 (9th Cir. 1998). It deprives the wrongdoer of the ill-gotten gains obtained from his specific securities violations by returning him to the position he would have been in absent the illegal conduct. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). Thus adjudication of the violation is primary; disgorgement is a sanction imposed only after a finding that the respondent is liable for the violation alleged in the OIP.

Equally important, the Initial Decision fails to recognize that the distinct unregistered sales transactions at issue in each of the proceedings constitute separate Section 5 violations under applicable statutes and controlling legal precedent, as discussed above. There was no single "right" to institute proceedings for an omnibus Section 5 violation that required all transactions to be included under the umbrella of one proceeding.

C. The Initial Decision Erroneously Determined That A Final Judgment Was Reached In The Prior Proceeding On Whether Pierce's Unregistered Sales Through The Newport And Jenirob Accounts Violated Section 5.

The Initial Decision also erroneously found that the second element of res judicata – entry of a final judgment on the merits of the present claim – was met. ID at 14. The Initial Decision's stated legal ground for this finding was that a final judgment generally resolves all issues as to all parties and that it is irrelevant if some issues were not adjudicated on the merits. *Id.* (citing cases). The Initial Decision stated: "[t]hat liability for additional disgorgement suggested by the Liechtenstein [Newport and Jenirob] Documents was not adjudicated makes no difference." *Id.* This conclusion is plainly incorrect under applicable law.

Under controlling law, as the Supreme Court has explained:

> In order that a judgment may constitute a bar to another suit, it must be rendered in a proceeding between the same parties or their privies, and the *point of controversy must be the same in both cases, and must be determined on its merits.* If the first suit was dismissed for defect of pleadings, or parties, or a misconception of the form of proceeding, or the want of jurisdiction, or was disposed of on any ground which did not go to the merits of the action, the judgment rendered will prove no bar to another suit.

Costello v. United States, 365 U.S. 265, 286 (1961) (emphasis added). Adjudication on the merits "has a well settled meaning: a decision finally resolving the parties' claims, with res judicata effect, that is based on the substance of the claim advanced, rather than a procedural or other ground." *Sellan v. Kuhlman*, 261 F.3d 303, 311 (2d Cir. 2001) (adjudication involves the final settlement of the rights and duties of the parties on the merits of the issues raised); *see Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 502, 505-06 (2001) (common connotation of term "judgment on the merits" is "one in which the merits of a party's claim are in fact adjudicated for or against the party after trial of the substantive issues).

Dismissals for lack of jurisdiction or similar procedural grounds do not operate as an adjudication on the merits. "Even where a second action arises from some of the same factual circumstances that gave rise to a prior action, res judicata is inapplicable if formal jurisdictional or statutory barriers precluded the plaintiff from asserting its claims in the first action." *Computer Assoc. Int'l v. Altai*, 126 F.3d at 370; *see Criales v. American Airlines, Inc.*, 105 F.3d 93, 96-97 (2d Cir. 1997) (dismissal would not bar subsequent suit where plaintiff had failed to comply with precondition requisite to court's going forward to determine merits of his substantive claim). As the *Criales* court observed, "in properly seeking to deny a litigant two days in court, courts must be careful not to deprive him of one." *Criales,* 105 F.3d. at 98.

As discussed above, the judgment in the First Proceeding concerned the Division's claim that Pierce violated Section 5 by his unregistered sales of Lexington stock through his personal account. Although ALJ Foelak admitted evidence concerning Newport and Jenirob for liability

purposes, the First Initial Decision makes plain that adjudication of a Section 5 violation and attendant disgorgement based on the unregistered Newport and Jenirob sales was beyond the scope of the First Proceeding. *See* Buchholz Decl. II Ex. J at 15, 20. The First Initial Decision discussed only Pierce's sales from his personal account in analyzing the Division's *prima facie* case against Pierce for violation of Section 5. *Id.* at 15. Nowhere does the First Initial Decision discuss whether the Newport and Jenirob sales violated Section 5, much less whether disgorgement of the proceeds of those sales would be an appropriate sanction for the violation.

Procedurally, ALJ Foelak's ruling on the Newport and Jenirob sales is analogous to a dismissal of the claim without prejudice for lack of authority to adjudicate it. In essence, a procedural finding that the ALJ was without authority to adjudicate whether disgorgement of the proceeds of the unregistered Newport and Jenirob sales was appropriate can only mean that there was no decision on the substance of that claim. As the present claim therefore was not adjudicated in the First Proceeding, the Initial Decision's finding that there was a final judgment on the merits of the present Section 5 violation was clearly erroneous.

D. The Initial Decision Erroneously Used A Res Judicata Analysis Applicable To Federal District Courts Of General Jurisdiction.

Application of res judicata in the present context should be carefully circumscribed, given the procedural limitations inherent in administrative proceedings. Here, while admitting the Section 5 violation in the present proceeding, Pierce invoked res judicata as an affirmative defense, alleging that the Division had engaged in impermissible piecemeal litigation by "splitting" its Section 5 claims. The Initial Decision's finding that this defense would apply but for Pierce's concealment raises significant procedural and policy issues.

Section 24(a) of the Restatement (Second) Judgments makes clear that "[e]quating claim with transaction is justified only when the parties have ample procedural means for fully

developing the entire transaction in one action going to the merits to which the plaintiff is ordinarily confined." It assumes as a standard the existence of a modern procedural system in which there is considerable freedom of amendment and the parties can resort to compulsory process to ascertain the facts surrounding the transaction. The *Restatement* recognizes, however, that exceptions should be allowed where jurisdiction is more limited, citing Section 26(c). In turn, Section 26(1)(c) states that res judicata does not apply in a second action when the plaintiff was unable to obtain certain relief in the first action because of limitations on the court's jurisdiction or restrictions on the court's authority. Further, Section 83, comment *g*, cautions that "[t]he qualifications and exceptions to the rule of claim preclusion have particular importance with respect to adjudications by administrative agencies" because, in contrast to Article III courts, the jurisdiction of administrative agencies is more limited.

In the context of adjudications by administrative agencies, as here, "limitations on the authority of the tribunal should carry corresponding limitations on the scope of 'claim' for purposes of the rule of claim preclusion." *See Texas Employer's Ins. Assoc. v. Jackson*, 862 F.2d 491, 502-03 (5th Cir. 1988) (denying application of res judicata where administrative proceeding was without jurisdiction to hear matters asserted in the plaintiff's state suit and citing Wright Miller & Cooper § 4412 at 93, explaining "[i]t is clear enough that a litigant should not be penalized for failing to seek unified disposition of matters that could not have been combined in a single proceeding, and even clearer that no penalty should be inflicted if a deliberate attempt to combine such matters has been expressly rejected"); *see also Computer Assoc.*, 126 F.3d at 370 ("Even where a second action arises from some of the same factual circumstances that gave rise to a prior action, res judicata is inapplicable if formal jurisdictional or statutory barriers precluded the plaintiff from asserting its claims in the first Action," citing *Restatement*

§ 26(1)(c)); *Sekaquaptewa v. MacDonald*, 575 F.2d 239, 246-47 (9th Cir. 1978) (claims could not have been asserted in prior action because court was not given jurisdiction to decide them).

These principles strongly suggest that the claim-splitting rationale of res judicata should not apply to the Section 5 claim against Pierce in this proceeding. The logic of the res judicata cases cited by the Initial Decision (as well as by Pierce) is that res judicata should bar piecemeal litigation of the same harm. *See, e.g., Mpoyo* at 988; *Western Sys., Inc. v. Ulloa*, 958 F.2d at 871-72. In these cases, private plaintiffs in courts of general jurisdiction failed to pursue information known or available to them during their earlier actions in which procedural rules afforded them compulsory discovery process and liberal (timely) opportunity to amend or in which they had sought to assert new legal theories based on facts already known to them.

Unlike such cases, the Division did not have the evidence it needed to assert the present Section 5 claims when the First Proceeding was instituted and res judicata therefore should not apply. As the Initial Decision stated,"[t]he rule against splitting causes of action serves no purpose if a plaintiff cannot reasonably be expected to include all claims in the first action," citing *McCarty v. First of Georgia Ins. Co.*, 713 F.2d 609, 612 (10th Cir. 1983). ID at 19; *cf. Jefferson Smurfit Corp. v. U.S.*, 439 F.3d 448, 451 (8th Cir. 2006) (whether further deficiencies could be assessed even after Tax Court judgment is determined by examining language, structure and purpose of applicable statute).

Further distinguishing these cases are the procedural limitations of cease and desist proceedings, which fall within the exception to the prohibition against piecemeal litigation in Section 26(c) of the *Restatement*. Congress mandated such proceedings to allow the agency "to move quickly" in response to fraudulent activity. 101 Cong. Rec. H5257 (daily ed. July 23, 1990) (Rep. Markey). Under the Commission's Rules of Practice governing administrative

proceedings, discovery is severely limited, the ALJ lacks authority to expand the scope of the OIP, extensions of the 60 day hearing deadline are disfavored; and the time for issuing an Initial Decision is at most 300 days from service of the OIP. *See* SEC Rules of Practice 161, 230-234, & 360. While Commission rules allow amendment of an OIP during a pending proceeding, as the Initial Decision correctly held, amendments are "subject to the consideration that other parties should not be surprised, nor their rights prejudiced." ID at 13 (*citing* SEC Rule of Practice 200(d), 17 C.F.R. § 201.200(d); 60 Fed. Reg. 32738, 32757 (June 23, 1995); & *Carl L. Shipley*, 45 SEC 589, 595 (1974)).

These procedural limitations directly affect the Initial Decision's holding that the Division's present Section 5 claim could have been litigated in the First Proceeding. As explained above, the facts indicate otherwise because the Newport and Jenirob evidence was not received until after the hearing, Pierce opposed its admission on due process grounds and ALJ Foelak adjudicated only the Section 5 violation for Pierce's sales from his personal account. Indeed, as the Initial Decision correctly found, a motion for leave to amend the First OIP in such circumstances was not required and likely would have been futile. ID at 13.

In addition, there are significant policy and procedural reasons to correct the Initial Decision's erroneous finding that res judicata would apply to this proceeding, absent concealment. Allowing a res judicata defense in the present context could give a strong incentive to securities violators to split their unregistered sales into a maze of offshore accounts in many jurisdictions, as Pierce did here. Such a result could present a serious impediment to the Division's enforcement efforts. The Division would be forced either to wait indefinitely for evidence, including via assistance from foreign regulators, that may never come, or to file a narrower proceeding before all evidence has been received, thereby effectively giving immunity

from liability for other transactions for which the staff had not obtained evidence at the time of the filing.

Pierce's assertion of a res judicata defense in an effort to bar the Division's present Section 5 claim when he opposed adjudication of the identical claim discovered after the hearing in the First Proceeding presents exactly the type of concern for potential abuse of res judicata raised above. Hence, these policy and procedural reasons provide additional support for correction of the Initial Decision's application of res judicata to this proceeding.

VII. CONCLUSION

For all the foregoing reasons, the Division requests that the Commission correct the erroneous res judicata analysis in the Initial Decision, while upholding the Initial Decision's ruling that Pierce violated Section 5 of the Securities Act, as well as the sanctions the Initial Decision imposed against Pierce for this violation.

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Respectfully submitted,

Marc J. Fagel
Michael S. Dicke
John S. Yun
Judith L. Anderson
Steven D. Buchholz
Attorneys for DIVISION OF ENFORCEMENT