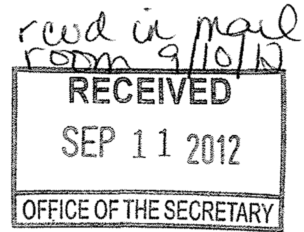

ADMINISTRATIVE PROCEEDING
FILE NO. 3-14355
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

DONALD L. KOCH AND
KOCH ASSET MANAGEMENT, LLC

RESPONDENTS' MEMORANDUM OF LAW IN SUPPORT OF APPEAL OF INITIAL DECISION

September 10, 2012

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INTRODUCTION [1]

The resolution of this action hinges on the duties of an investment adviser to his clients. Specifically, the question here is whether an investment adviser making client purchases to move up their securities holdings and reduce cash by placing a limit order for highly illiquid securities and directing small executions which slowly ladder up the price to draw sellers into the market so a block of stock can be acquired and give the adviser a closing price within the limits of its investment program violated the antifraud provisions. The answer can only be determined after a careful examination of all the evidence.

Koch Asset Management LLC ("KAM"), founded by Donald L. Koch, is a highly successful investment adviser. It invests in only small bank stocks, purchasing at prices at or below what it calculates to be tangible book value ("TBV"). The advisory was born of the career experiences of Donald L. Koch, a longtime banker, Federal Reserve executive and college economics professor who crafted a highly successful, personal investment program cloned at the request of friends to become KAM. Through the turbulent market crisis years of 2007 to 2009 the program gave those friend - clients an average return on equity of 42%.

In September and December 2009 KAM sought to invest excess cash for two longtime clients. In each month KAM searched for shares of High Country Financial Corporation ("High Country"), a longtime favorite. In December the adviser also sought shares of Cheviot Financial Corporation ("Cheviot") and Carver Financial Corporation ("Carver"). All three were small regional banks whose securities were highly illiquid, trading only on some days, in very low volume and frequently with huge bid-ask spreads. Because of the difficulty of acquiring these securities, particularly in the market crisis environment of 2009, KAM utilized trading

[1] Pursuant to Rules 410 and 450 of the Commission's Rules of Practice, Respondents Donald L. Koch and Koch Asset Management, LLC ("Respondents) hereby submit their memorandum of law in support of their appeal of the Initial Decision rendered in the above-captioned action on May 24, 2012 (the "Initial Decision" or "ID").

techniques based on its experience and the academic literature to ferret out sellers. Those included:

- ***Study***: Carefully assessing the market conditions on a particular day;
- ***Liquidity***: Seeking shares when the market was most liquid, typically at the end of a month, period (third quarter 2009, September 30) or the year end (December 31);
- ***Order***: Using limit orders rather than market orders to limit market risk from a price run up;
- ***Price***: Setting a target price at or below TBV which is high enough to attract buyers as the order is executed and the share price slowly ladders up because of the illiquidity of the stock;
- ***Timing***: Routing orders to the market late in the afternoon when the market is typically more liquid, such as about an hour before closing on September 30;
- ***Execution***: Seeking order executions in small units such as 100 or 200 shares to minimize market impact as for the September and December purchases; and
- ***Sellers***: Drawing sellers into the market for the difficult to find and illiquid stock through a series of small executions reflecting consistent demand at prices which through market dynamics inevitably laddered up slowly to a point KAM saw as its closing price, such as $20 for High Country on December 30 but which were at or below its $25 TBV limit.

This trading approach is reflected in part by one September and two December e-mails and six December 31 audio tapes captured portions of conversations between Mr. Koch and the trader who executed the purchase orders. The tapes, which are conversations between two men who understand each other and thus often spoke in clipped phrases which shifted subjects, when viewed as part of all the evidence, paint a picture of an adviser using a sophisticated trading approach and market dynamics to fulfill its duties to clients, but which in isolation may be very misleading since listening to them is like walking into the middle of a conversation.

The validity of KAM's approach in making the purchases in September and December is verified by four undisputed points. First, former SEC Chief Economist, Professor Gregory Jarrell testified that there was no evidence of manipulation or marking the close as alleged in the

Order Instituting Proceedings ("OIP") in this action as to the purchases of Cheviot and Carver in December by KAM. While the illiquidity and volatility of High Country, which he likened to buying shares in a private placement, precluded a similar analysis, the undisputed evidence establishes that the shares were all purchased at prices comparable to those in other non-KAM transactions.

Second, KPMG partner John Schneider, who conducted an extensive analysis of KAM's investment policies, programs and trading history, concluded that all the purchases were fully consistent with the adviser's program and its historical transactions. Third, Jeffery Christanell, the trader at Huntleigh Securities LLC ("Huntleigh") who executed all of the trades and testified for the Division, admitted on cross-examination that all of KAM's purchases received best execution. Finally, there is no evidence the shares purchased were sold even after the OIP in this case was issued. In sum, the totality of the evidence demonstrates that KAM and Mr. Koch acted precisely as an adviser should: in the best interests of the clients. Indeed, there is no other motive for the four purchases. This proceeding should be dismissed.

THE ISSUES PRESENTED IN THE PETITION FOR REVIEW

1. Whether the initial decision should be rejected since it fails to find key statutory elements, identify the standards used or specify the supporting facts.

2. Whether this proceeding should be dismissed since the shares were purchased for investment utilizing established market dynamics which the totality of the evidence demonstrates were employed to draw sellers of difficult to acquire securities to the market so the shares could be acquired.

3. Whether additional sanctions are warranted if there is a finding of violation since that finding will preclude a reoccurrence and penalize Respondents who are out of the advisory business. [2]

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[2] The issues specified in the Petition For Review and the Commission's Order of July 26, 2012 are subsumed in these three, broad points above. The issues specified in the Petition are: 1) Whether the Initial Decision properly identified a standard for concluding that there was an artificial price and whether the Initial Decision specifies any facts demonstrating an artificial price; 2) Whether intent alone can support a finding of marking the close; 3) Whether, if intent alone can establish making the close, intent in fact existed under the circumstances in this case; 4) Whether Mr. Koch can be a primary violator; 5) Whether the Initial

PROCEDURAL HISTORY

The Order Instituting Proceedings ("OIP") was issued on April 25, 2011. It names as Respondents KAM and Donald L. Koch. A hearing commenced on January 10 and continued through January 13, 2012 in St. Louis, Missouri. It concluded with testimony on January 17 and 20, 2012 in Washington, D.C.

An initial decision ("ID") by Administrative Law Judge Carol Fox Foelak was filed on May 24, 2012. A timely Petition for Review was granted by the Commission in a July 26, 2012 order which also directed that the question of sanctions be reviewed.

THE ORDER INSTITUTING PROCEEDINGS

The OIP alleges willful violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act") based on purchase of High Country shares on September 30, October 30 and November 30, 2009. Violations of the same sections are also alleged based on the purchase of High Country, Cheviot and Carver on December 31, 2009. In addition, the OIP also alleged violations of Advisers Act Section 206(4) and Rule 206(4)-7(a) for failing to maintain certain books and records and to implement anti-manipulation policies and procedures.

The OIP claims that the stock purchases by KAM on each of the four specified dates constituted market manipulation by "marking the close" and failing to seek best execution. In the OIP the claims were based largely on three e-mails, one dated September 30, 2009 ("September e-mail"), two dated December 23 and 28, 2009 ("December e-mails") and six

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Decision properly identifies a standard and factual basis for concluding that Respondents necessarily failed to implement KAM's policies and procedures; and 6) Whether the sanctions recommended by the initial Decision are improper.

recordings made by Huntleigh Securities on December 31, 2009 of conversation between Mr. Koch and brokerage firm trader, Jeffrey Christanell. The motive for the claimed wrongful conduct was to "artificially improve the reported monthly performance for each account holding that security." OIP at ¶ 6.

THE HEARING

The Division of Enforcement called four witnesses at the hearing while Respondents called six. Approximately 131 exhibits were received in evidence.[3] The Division's witness were:

- ***Cathy Marshall***: Huntleigh compliance director, who testified regarding the history of KAM's accounts at the firm and its brief assessment of the security purchases involved here following a regulatory inquiry regarding the shares of Cheviot purchased on December 31, 2009. Tr. 35-220 (Marshall).

- ***Jeffrey Christanell***: Huntleigh trader, who testified regarding the purchase orders on each date involved here and identified the September and December e-mails (respectively, Exhs. 148, 186 and 194) The first directed Mr. Christanell not to appear manipulative in executing KAM trades. The second and third alerted the trader that KAM would seek to purchase High Country shares on December 31. He identified the six audio tapes (Exhs. 188 through 193) as recording of conversations between he had with Mr. Koch on December 31, 2009 about the market conditions, placing the orders in small lots to avoid disturbing the markets, acquiring shares to move up the client stock holdings and obtaining KAM's last execution at specified prices after the share price laddered up to draw sellers to the market. Tr. 551-52 (Christanell).

- ***Stephen Glascoe***: A Division employee, presented statistical evidence, tabulating the claimed increase in advisory fees from the purchases here based on assumptions including one which assumes that all KAM family and advisory clients paid fees. He also calculated the claimed increase in value of all KAM advisory and family accounts resulting from the purchases, again based on certain assumptions.

- ***Eli Straeter***: A data specialist for Huntleigh testified regarding the six tapes, noting that all of the recordings before and after December 31 had been deleted. The six recordings were the only ones that could be retrieved. While he theorized about the reasons, in fact he had no explanation.[4] Tr. 397-412 (Straeter).

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[3] A detailed compilation of the hearing evidence along with pertinent citations to the record is contained in Respondents' Proposed Findings of Fact and Conclusions of Law, filed on February 29, 2012 ("Respondents' Proposed Findings"), at 7-76.

[4] There are significant questions regarding the admissibility and reliability of the recordings. *See* Respondents' Proposed Findings, n.10.

KAM presented testimony from six witnesses:

- ***Donald L. Koch***: Testified regarding the origins of KAM, its investment program and its investment strategy. The firm purchased only small, regional bank stocks priced at or below TBV. The securities were typically difficult to acquire because of their illiquidity. Mr. Koch flatly denied manipulating the share price of the three stocks cited in the OIP, stressing that the purchases were made only as investments for the clients. In acquiring the stocks to move up the securities holdings of clients, the firm used market dynamics and proven, accepted trading techniques carefully calibrated to obtain executions of the difficult to acquire stocks within the limits of the investment program agreed to with each client. Tr. 859-60 (Koch).

- ***Fay Heidtbrink***: KAM record-keeper, described the meticulous records maintained by the firm. She stated that KAM had voluntarily waiver about $234,193 since 1996. In 2009 the firm waived $32,086 in advisory fees. She also described the charitable foundation created and funded by Mr. Koch to educate students regarding U.S. history. Tr. 680-720 (Heidtbrink).

- ***Don Cayce***: Has invested with KAM for years. He is a high school graduate who built a successful business that he later sold – the source of his investment funds. He detailed the very successful investment approach used by KAM to grow his investment account and the periodic meetings he has had with Mr. Koch regarding those investments. He has high regard for Mr. Koch because of his integrity and fair dealings with his clients and friends. After learning about the OIP he continued as a KAM client until Mr. Koch essentially closed the advisory. Tr. 639-47 (Cayce).

- ***James Ewoldt***: Has also successfully invested with KAM for years on behalf of his wife. He is a retired partner of Arthur Anderson where he held a number of senior positions in the tax department. He recounted the KAM investment program, noting that it was only for long-term investors, described his periodic meetings with Mr. Koch and attested to its success. He attested to Mr. Koch's reputation for honesty and fair dealing. After learning of the charges in the OIP he continued as a client until Mr. Koch essentially closed the advisory. Tr. 650-56 (Ewoldt).

- ***Professor Gregory Jarrell***: Is a professor at the graduate school of business at the University of Rochester and a former Commission Chief Economist who testified as an expert witness on market economics. He testified that:

    - Shares of High Country, Cheviot and Carver are extremely illiquid, a fact reflected in their large bid ask spreads, unavailability on many trading days and very low trading volume. The best time to acquire such securities is when the market is most liquid, typically at the end of periods and either early in the morning or late in the day. Tr. 1136-37 (Jarrell).

    - Purchases of these stocks have to be made with caution since virtually any trade will move the price. Small buys will cause a slow laddering effect of the price.

Large acquisitions could cause a price spike. When buying these securities, it is prudent to use limit orders to cap the exposure. At the same time, the difficulty of purchasing these shares means that to buy a block the price may have to be at or above the bid or above. Tr. 1128-29 (Jarrell).

- o An examination of the KAM purchases of Cheviot and Carver did not evidence any indication of manipulation. KAM's purchases of these two stocks did not set the closing price on December 31. Each purchase was made at prices comparable to those paid in other non-KAM transactions. The same analysis could not be done for the purchases of High Country because of its illiquidity and volatility. That stock is so illiquid, purchasing it is more like negotiating a private placement than buying a stock on an exchange. Its illiquidity also makes it extremely volatile with prices bouncing between the huge bid and ask spread, a phenomenon he called the "bid ask bounce." Nevertheless, careful analysis demonstrated that each purchase of High Country made by KAM during the period here was at prices comparable to those paid in non-KAM transactions. Tr. 1060-61, 1083, 1103 (Jarrell).

- ***John Schneider***: Is a partner at KPMG who testified as an expert in accounting regarding investment advisers. He concluded, based on his extensive analysis of KAM's investment policies and program, that KAM has consistently followed the investment program agreed with its clients. That program has resulted in an average return on equity of 42% through the market crisis years. The purchases of High Country, Cheviot and Carver here were consistent with the investment objectives of the program and with earlier transactions. KAM's record keeping is detailed and meticulous. The firm produced all responsive documents on its computers during the Commission's investigation, according to a forensic analysis of the hard drives. Tr. 1009 (Schneider).

THE INITIAL DECISION

The Initial Decision concludes that KAM and Mr. Koch violated Exchange Act Section 10(b), and Rule 10b-5 thereunder, and Advisers Act Sections 206(1) and (2) by "marking the close as to the purchases of High Country securities made on September 30, 2009 and December 31, 2009. It makes the same finding as to the purchases of Cheviot and Carver on the last day of December 2009. While the Initial Decision concludes that there was an artificial price it does not define that concept or specify the supporting evidence.

The findings of violations are based on the conclusion that Mr. Koch intended to manipulate the share price. This is based on the text of the September and December e-mails and the six tapes. There is no discussion of the manner in which the purchases were executed or

synthesis of the factual record. The motive was to increase advisory fees for the third and fourth quarters of 2009 by a total of $4,169.78. There is no reference to the fact that KAM voluntarily waived more than this amount of fees in 2009 and other years. The ID did conclude that the testimony of Professor Jarrell and Mr. Schneider constituted a complete defense to the OIP charges except for Mr. Koch's intent as reflected in the three e-mails and six recordings.

The Initial Decision also concludes that KAM and Mr. Koch violated Rule 206(4)-7(a) by failing to implement its policies and procedures to preclude manipulation. This is based on the fact that KAM has one employee, Mr. Koch, who is also the chief compliance officer of the firm which the ID says is his alter ego.

The Division failed to establish its claims regarding the purchases in October, November and December. It also failed to establish a record keeping violation. No mention is made of the failure to obtain best execution charge.

The Initial Decision concludes by determining that a cease and desist order should be entered as well as disgorgement in the amount of $4,169.78 along with prejudgment interest and a second tier penalty of $75,000. Finally, it concludes Mr. Koch should be barred from the business. Yet there is no meaningful discussion of "willfulness" or the public interest to support these determinations.

ARGUMENT

I. THE INITIAL DECISION SHOULD BE REJECTED SINCE IT FAILS TO FIND KEY STATUTORY ELEMENTS, IDENTIFY THE STANDARDS USED OR SPECIFY THE SUPPORTING FACTS.

The Initial Decision should be rejected since it fails to make findings on required statutory elements, to specify the standards used to reach its conclusions, and to delineate the supporting facts. This is apparent from a consideration of three points: 1) the requirements for concluding that there is a violation of Exchange Act Section 10(b) and Advisers Act Sections

206(1) and (2); 2) the dictates of Section 206(4) regarding the implementation of procedures; and 3) the elements specified in Advisers Act Section 203 for imposing sanctions.

A. The ID's Conclusion That The Antifraud Sections Were Violated Should Be Rejected Since It Fails To Find Deception As Required By the Statutes.

The OIP charges Respondents with violating Exchange Act Section 10(b) and Advisers Act Sections 206(1) and (2) through manipulation, that is, by "marking the close" and failing to obtain best execution. To prove manipulation these Sections require proof of deception in the market place. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 473 (1977); *SEC v. Capital Gains*, 375 U.S. 180, 190 (1963). This means, in the context of this case, that to find a violation of these Sections the ID must conclude that investors in the market place on September 30 and December 31, 2009 were deceived by Respondents' actions. There is no such finding. Yet without this conclusion, supported by the pertinent facts, the ID's findings of violations must be rejected.

While the ID does state that there was an artificial price which would imply deception, this statement will not support the conclusion that there were violations. The standard used to reach this conclusion, the supporting facts, and its connection to the conduct here are all unspecified. ID at 14. Such a bald and unilluminating claim is of no import. *See, e.g, Rapoport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012) (agency must specify standards). This is particularly true here since not only is the standard used to reach this conclusion unidentified, but the supporting facts are not specified. *See* ID at 14. These failures leave the artificial price conclusion untethered from Sections 10(b) and 206(1) and (2).

Not only does the ID fail to ground its claimed violations in deception or identify the supporting facts, but it is laced with contradictions. First, the ID acknowledges that the testimony of Dr. Jarrell and Mr. Schneider would be a complete defense but for what it sees as evidence of

intent. ID at 10. Dr. Jarrell testified that there was no manipulation and thus no artificial price. Mr. Schneider's analysis established that the purchases here by KAM were fully consistent with the adviser's long established and highly successful investment program. The acknowledgement that this testimony constitutes a complete defense is recognition that there was no deception, artificial price or manipulation and thus nothing but what it perceives to be Mr. Koch's intent. Not only does this directly contradict the ID's statement that there is an artificial price, it is nonsense. Intent standing alone cannot create an artificial price and deception in the market place. Indeed, intent, thought, thinking or even wishing is not a crime since it is constitutionally protected. *See Wooley v. Maynard*, 430 U.S. 705, 714-15 (1977) (the First Amendment protects thought and belief from punishment); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 234-35 (1977) (same); *see also U.S. v. Balsys*, 524 U.S. 666, 714 (1998) (the First Amendment "protects against the prosecution of thought crime") (Breyer, J., dissenting).

This confused and contradictory conclusion is followed by a second. Quoting a Commission decision, the ID states that "[m]arking the close 'is the practice of *attempting* to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market.'" ID at 12 (quoting *Thomas C. Kocherhans,* Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530) (emphasis added). Whether this means that the Respondents only "attempted" to manipulate or actually did manipulate is not specified. Whether the ID concluded that the conduct constituted an "attempt" or an "actual" manipulation however, there still must be a specification of the standard by which the conduct was assessed and a detailing of the supporting facts. And, whichever it is, to conclude there was a violation of the statutes there must be a finding of deception in the market place caused by Respondents. None of this was done. The conclusion that there were violations is without foundation and cannot stand.

Third, the Initial Decision fails to make any finding or even mention the OIP charge of failure to obtain best execution, again undercutting its conclusions. While marking the close is distinct from best execution, the two concepts overlap. *See, e.g.*, *NetCoalition v. SEC*, 615 F.3d 525, 530, n.6 (D.C. Cir. 2010) (the duty of best execution requires a broker-dealer "to exercise reasonable diligence to obtain favorable order execution terms for customers"). If Respondents marked the close and created an artificial price, then the prices paid for the purchased securities would have been inflated by their own doing, that is, not at the best prices which would otherwise have been available in the market place. *See Dumont v. Charles Schwab & Co., Inc.*, 2000 WL 1023231, at *2 (E.D. La. Jul. 21, 2000) ("'[B]est execution' of a client's order to purchase stock is the placement of that order in the market which has the lowest asking or purchase price available at the time the order is placed by the broker."). The failure of the Initial Decision to even mention this point can only be read as a failure of proof by the Division. *See, e.g.,* Rule 360, *SEC Rule of Practice* (requiring the ID to make findings of fact and conclusions of law). This is particularly true since Division witness Jeff Christanell admitted on cross examination that each of KAM's purchase received best execution (Tr. 591 (Christanell)) thereby directly undercutting any conclusion that Respondents marked the close. Failing to rectify this critical conflict, as well as the other others, coupled with the failure to make a critical statutorily required finding and to delineate the necessary supporting facts compels the conclusion that the ID must be rejected.

B. The ID's Conclusion Regarding Section 206(4) Should Be Rejected Since It Impermissibly Rewrites The Standard.

The conclusion that KAM violated Section 206(4) and Rule 206(4)-7(a) by not properly implementing its anti-manipulation policies is flawed. It fails to identify the legal standard used

and perhaps more importantly, apparently crafts a new one from whole cloth while ignoring Commission policy.

First, after acknowledging that KAM adopted Policies and Procedures the ID claims that because "KAM was a one man firm and Koch was its alter ego as well as its Chief Compliance Officer, it is concluded that KAM and Koch did not implement the anti-manipulation policy and thus violated the rule." ID at 15. This statement assumes that Mr. Koch is the alter ego of the firm because he is the only employee and then further assumes that this is a violation of the Section and the Rule. Regardless of the validity of pyramiding assumptions on one another without citing any authority, the ultimate conclusion means that every investment adviser which has only one principal *per se* fails to implement its policies and procedures and violates the law. If this is to become the standard it cannot craft in an enforcement action. *See, e.g.*, *Rapoport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012) (agency must specify standards).[5]

Second, to the extent the conclusion rests on the finding of violation – even assuming that conclusion were correct, which it is not – it is nothing more than hindsight, which cannot be used as the basis for a finding of violation. *See Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) (fraud by hindsight is not permitted). To the contrary, the Commission has always made it clear that the failure of procedures to prevent a violation does not necessarily mean that they are defective. *See, e.g.*, *S.E.C. Charges Former Morgan Stanley Executive with FCPA Violations and Investment Adviser Fraud*, S.E.C. News Digest 2012-80, 2012 WL 1426055, at * 1 (Apr. 25, 2012) (Commission declined to prosecute Morgan Stanley in view of its compliance procedures

[5] In similar fashion the ID concludes that KAM and Mr. Koch are alter egos. ID at 14-15. The only fact offered to support this claim is that the firm has one employee. *Id.* If that were true then every small business might be viewed as the alter ego of its owner. It is not surprising that no citation of authority is offered for this determination – it would rewrite state corporation law. Here, KAM, not Mr. Koch is the investment adviser. The actions alleged in the OIP were those of KAM, which is the only person authorized to trade for its clients. Accordingly, only KAM could be a primary violator. *See Janus Capital Group, Inc. v. First Derivative Traders*, -- U.S. --, 131 S. Ct. 2296, 2301-02, 180 L. Ed. 166 (2011).

despite the fact that senior official violated the FCPA). Accordingly, the conclusion that there was a violation of Section 206(4) and Rule 206(4)-7(a) must be rejected.

C. The ID's Conclusions on Sanctions and Disgorgement Should Be Rejected Since They Are Not Based On The Statutorily Required Elements And Rely On an Incorrect Disgorgement Calculation.

The ID's conclusions as to sanctions and disgorgement should be rejected for two reasons. First, the sanction findings omit statutorily required elements. Second, the disgorgement calculation is based on a tabulation predicated on an incorrect assumption.

First, Section 203(k), which governs the entry of a cease and desist order, specifies that such an order is only appropriate if the underlying wrongful conduct is "willful." Advisers Act, § 203(k). Likewise, a bar, censure and penalty cannot be ordered absent a finding of willfulness. Advisers Act Sections 203(f) (bar); 203(e)(6) (censure); 203(i) (penalty). Here there is no finding of willfulness other than the finding that Respondents intended to trade as they did. The ID is thus contrary to the statutes.

Likewise, in order to impose a penalty, there must be a finding that it is in the public interest, as defined by Section 203(i)(3), in addition to the willfulness finding. Simply reciting the phrase "public interest' is not sufficient. Rather, that Section requires that there be an analysis of the applicable facts. The ID omits the statutorily required analysis. Again, its conclusion must be rejected.

Finally, the disgorgement finding is simply wrong. Disgorgement can only be ordered to require the wrongdoer to divest ill-gotten gains. *See, e.g., SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). While it need not be calculated with precision, the tabulation must represent a reasonable approximation of the ill-gotten sum. *See id.*; *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004).

Here the ID directs the payment of a sum of $4,169.78 based on a calculation by the Division. ID at 16-17. The sum was calculated using the opening bid for High Country on September 30 and a non-KAM price for December 31 based on the assumption that the closing prices had been manipulated. This also assumes that either of those prices represents a true value for the stock. Not only is there no proof for this supposition, it is belied by the wide bid-ask spread for the stock.[6]

Finally, the supposition ignores the manner in which KAM actually calculates advisory fees. When an illiquid stock such as High Country does not trade and there is no value or an assumed value on the month end brokerage, statement KAM does not rely on the opening bid because it does not represent the value of the stock. Rather, the firm estimates the value of the security to calculate the fees and discloses that fact to the clients. Tr. 703-05 (Heidtbrink); Tr. 869-71 (Koch). The failure of the ID to utilize this methodology or some similar calculation to estimate ill-gotten gains and its reliance on an unsubstantiated assumption requires that the calculation be rejected.

II. THIS PROCEEDING SHOULD BE DISMISSED SINCE THE SHARES WERE PURCHASED FOR INVESTMENT UTILIZING ESTABLISHED MARKET DYNAMICS WHICH THE TOTALITY OF THE EVIDENCE DEMONSTRATES WERE EMPLOYED TO DRAW SELLERS OF DIFFICULT TO ACQUIRE SECURITIES TO THE MARKET SO THE SHARES COULD BE ACQUIRED.

The proceeding here should be dismissed because the charges in the OIP, like the conclusions in the Initial Decision, are based on evidentiary fragments rather that the totality of the evidence which demonstrates KAM purchased the shares as part of an on-going long term investment program using well established market dynamics and techniques to draw hard to

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[6] The methodology used by the Division appears to have been borrowed from Huntleigh Securities to a certain extent. When a stock does not trade on the last day of the month, the firm inserts the opening bid on the monthly statement. Appendix A at 1 to Respondents' Proposed Findings; Exh. 12. The firm does not use this methodology to calculate value. Tr. 704-05 (Heidtbrink). Other firms use different methods under these circumstances such as using the ask. If the Division used the ask rather than the bid as some firms do, the resulting amount would have been significantly lower.

acquire shares to the market so they could be purchased at competitive prices. This is apparent from consideration of three points: (1) the applicable legal standards; (2) the trading approach and techniques used by experienced traders to acquire illiquid securities; and (3) the specific purchases made by KAM on September 30 and December 31, 2009 for its clients.

A. The Legal Standards

The central charge here is that KAM and Mr. Koch engaged in market manipulation which, under Exchange Act Section 10(b) and Advisers Act Sections 206(1) and (2), is a term of art. *See Santa Fe*, 430 U.S. at 473. The term refers to actions such as wash sales and matched orders which are designed to deceive investors by feigning actual market activity. *See id; see also SEC v. Wilson*, 2009 WL 2381954, at *7 (D. Conn. 2009); *Setteducati*, SEC-NA 2002 Ref. No. 01580009 (Aug. 9, 2002), *aff'd*, Securities Exchange Act Release No. 48759 (Nov. 7, 2003). Stated differently, the trading activity deceives investors, the critical element of all manipulation schemes. *See Santa Fe*, 430 U.S. at 473.

Marking the close is a specific type of manipulative scheme. The point is to boost the closing price of a security beyond that which would exist in a competitive market. *Thomas C. Kocherhans*, Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530; *see also SEC v. Masri*, 523 F. Supp. 2d 361, 369 (S.D.N.Y. 2007) (marking the close is "the practice of repeatedly executing the last transaction of the day in a security in order to affect its closing price"). The deception is the artificially high, non-competitive closing price which can lure investors to the market on a false pretense.

Proof of manipulative schemes typically relies on inferences drawn from circumstantial evidence. *Pagel, Inc. v. SEC*, 803 F.2d 942, 947 (8th Cir.) (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983)). In drawing those inferences it is critical that the totality of

the evidence be considered. *Dodona I, LLC v. Goldman, Sachs & Co.*, 847 F. Supp. 2d 624, 638 (S.D.N.Y. 2012) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007)).

Motive is frequently critical in assessing all of the evidence and the inferences. While it is clear that the scheme need not succeed to violate the statutes, typically the manipulators seek some type of gain and do not have an investment purpose. *See Kocherhans*, Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530(profit by selling their shares at inflated prices); *Adrian C. Havill*, Exchange Act Release No. 74 (Aug. 31, 1995), 60 S.E.C. 310(needed to maintain high stock price); *Bruce B. Bowen*, Exchange Act Release No. 41 (Dec. 8, 1993), 55 S.E.C. 1711 (same). The absence of motive and an investment purpose, in contrast, raises a red flag which undercuts a claim of manipulation. *See SEC v. Cohmad Securities Corp.* 2010 WL 363844, at *3 (where motive is not apparent, circumstantial evidence must be stronger).

B. Purchasing securities in illiquid markets

Purchasing securities in illiquid markets, such as those involved here, differs from buying a stock on the New York Stock Exchange or on the NASDAQ. Buying shares on those exchanges is a simple matter of placing an order. Purchasing shares of stocks like High Country, Cheviot and Carver is essentially a hunt for liquidity, determining if, when, and in what quantity the security might be available. This is illustrated by some basic statistics:

2009	**NASDAQ**	**High Country**	**Cheviot**	**Carver**
Average daily volume	109,981 shares	212 shares	5,414 shares	1,857 shares
Days not available for purchase (252 trading days)	0	212 days	26 days	69 days
Bid- Ask Spread	0.24%	32.6%	4.9%	12.8%

Source: R. 36 at 23-25.

Other statistics amplify the point. In 2009 the average bid-ask spread for Fifth Thirdstreet Bank Corp. was $0.01. R. 36 at 22. On September 30, 2009 the bid ask spread for High Country at the open was $11.70 to $18.00. R. 39 at 43. On December 31, 2009, the bid as spread at the open for the securities here was: High Country, $14.05 to $16.80; Cheviot, $7.33 to $8.00; and Carver $8.08 to $10. (R. 36 at 36).

Experienced investors seeking to purchase shares of High Country, which Professor Jarrell compared to a private placement transaction (Tr. 1083 (Jarrell)), or even the slightly more liquid Cheviot or Carver and the other small bank stocks coveted by KAM and its clients requires a more sophisticated approach than simply placing an order with a broker. Seven key points are critical:

- ***Study***: Careful assessment of current market conditions on the day is essential as KAM did on the morning of September 30 and in preparation for year end 2009 as reflected in two e-mails to Mr. Christanell and in the recordings. Exhs. 148, 186, 188-193; Tr. 1122-23 (Jarrell).

- ***Liquidity***: Markets also tend to be more liquid at the end of periods such as the quarter or the year as on December 31, 2009 when shareholders may have a particular need to monetize their holdings. Tr. 621-22 (Christanell); Tr. 1122-23 (Jarrell); Tr. 861-62 (Koch).

- ***Order:*** Entering an order for an illiquid stock can move the price. This means that if a market order is entered it can cause the price to spike. Tr. 858-60 (Koch); Tr. 197 (Marshall). A limit order, by contrast, caps the exposure of the trader. KAM used limit orders set at or below tangible book value ("TBV"), a calculation done by the firm and agreed with its clients which was the maximum average price that would be paid for a security.[7] Tr. 859-60 (Koch).

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[7] TBV as calculated by KAM had three functions. First, it represented FDIC liquidation value. Tr. 771 (Koch). Thus if the purchase proved unprofitable and the bank failed, capping purchases at this value helped ensure that the client would not have a loss. *Id.* Second, many small community banks, such as those invested in by KAM clients, ultimately become take-over targets. Tr. 768-75 (Koch). Larger banks typically purchase these smaller institutions at multiples of TBV. Tr. 773-74, 821 (Koch). Thus TBV served to help maximize the profit for clients. Finally, it was a value discussed with, and agreed to, by the clients KAM served as thus acted as a check on the adviser to ensure that the investment objectives of these clients were being met. Tr. 798 (Koch). KPMG partner John Schneider, analyzed KAM's transactions for a representative group of clients over a period of 10 years and concluded that the adviser's transactions were all executed in accord with the investment objectives agreed with firm clients, no exceptions. Tr. 944 (Schneider); Exh. R. 36 at 6.

- ***Price:*** Prices quoted on a market are typically for 100 shares. If a block of shares is sought it may mean paying the ask price or above. Tr. 1128-29 (Jarrell); Tr. 843, 857-59 (Koch); Tr. 1128-29 (Jarrell).

- ***Timing:*** Markets tend to be deeper and more liquid at the beginning or end of the day, according to experienced traders and the academic literature. Tr. 1063-65 (Jarrell); Tr. 860-63 (Koch). Exh. R. 36 at 14-15. Trading at these times enhances price discovery for any security and, for illiquid stocks, the opportunity to purchase. Tr. 1122-23 (Jarrell).

- ***Execution:*** Executing orders in large blocks for illiquid securities can also cause a price to spike. In contrast, executing orders in small units of 100 or 200 shares avoids the spike. Tr. 1122 (Jarrell).

- ***Sellers:*** A series of small executions for an illiquid security will inevitably result in small prices increases, what Professor Jarrell called a "laddering" effect. Tr. 1122 (Jarrell). This can attract would be sellers to the market places as occurred on September 30. Exh. R. 36 at 14-15.

While each of these techniques can aid in acquiring illiquid securities, they are at times mimicked by manipulators which means that viewing the techniques in isolation rather than in the overall context of the transactions can be misleading.[8] To avoid chilling legitimate market activity, courts given the benefit of any doubt to the purchaser. *SEC v. Masri*, 523 F. Supp. 2d 361, 367-68 (S.D.N.Y. 2007) ("There may also be a concern that because of the ambiguity and difficulty in establishing intent, prohibition of otherwise legal conduct based only on an actor's intent might chill and deter socially desirable conduct.").

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[8] *See Kocherhans*, Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530 (manipulation case where trades entered within 15 minutes of market close); *Baron Capital, Inc.*, Exchange Act Release No. 47751 (Apr. 29, 2003) (trades entered at end of trading day). A key difference is, at times, the type of order. A manipulator may chose to use market orders which can cause a price spike in contrast to a limit order. *See, e.g., SEC v. Wilson*, 2009 WL 2381954, at *7 (D. Conn. 2009) (noting that trades placed as limit orders at 11 a.m. would be inconsistent with a marking the close scheme, whereas trades placed as market orders would be consistent with a marking the close scheme). The manipulator also lacks a rational economic or investment purpose for the transaction *See, e.g., Kocherhans*, Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530.

C. KAM's Purchases in September Were Made For An Investment Purpose Using An Approach and Techniques Tailored To The Market And Stock.

On September 30, 2009 KAM purchased 2,000 shares of High Country. The purchase was made as a long-term investment. The totality of the evidence demonstrates that the adviser used standard market techniques, adjusted to the stock and the turbulent market crisis conditions. The adviser tested the market early, adjusted and readjusted its approach, and acquired the block of securities at prices under the $25 TBV set for the stock.

The investment purpose: KAM sought to acquire a block of High Country shares for the account of Alice Smith, a client from the beginning of the advisory, and for whom the adviser had made significant returns. Her account had accumulated a substantial amount of cash. Tr. 907-08 (Koch). With real interest rates at near zero, it was prudent to move up the stock holdings in the account, investing the excess cash. Tr. 907-08 (Koch). High Country was a longtime KAM favorite, stemming from before its late 1990s IPO when Mr. Koch tried to acquire the bank. Tr. 838 (Koch).

Testing the market: In the morning, the initial spread for High Country was $11.70 to $18.00. KAM tested the market with a limit order for 400 shares at prices up to $18.00. Exh. 278 at 5; Exh. R. 39 at 43; Tr. 111-12 (Jarrell); Exh. R. 39 at 43. By mid-day the order had filled. Exh. R. 39 at 43.

Adjustments: At mid-day, KAM changed tactics. It increased the limit order to 600 shares – up by 200 – but lowered the limit price or cap to $16.00. Exh. 278 at 5; Tr. 1113 (Jarrell); Exh. R. 39 at 43. That cap was above the then-existing bid of $11.70, but well below the ask, which had increased to $20. This approach was not as successful. KAM only got a partial fill, acquiring 180 shares. Exh. R. 39 at 43. Under these conditions, KAM would not be able to acquire its usual block of stock, which helped minimize the transaction costs.

Readjusting: KAM adjusted again, seeking a larger block. At about 1:15 p.m., the adviser increased the order to 2,000 shares, up 1,400 from the earlier order. Exh. R. 39 at 21-26. At the same time, it increased the limit price over the existing ask of $20 to $25.00, which is TBV for that security under the adviser's program. *Id.*

Directions to the trader: A few minutes later Mr. Koch sent an e-mail to Huntleigh trader Jeff Christanell stating "move the last trade right before 3 p.m. up to as near to $25 as possible without appearing manipulative." Exh. 148. This was an hour before the close and would give KAM a last execution or closing price at or below the limit price set at TBV. Mr. Koch testified that this was a caution to the trader not to try to purchase large blocks as he typically did for other institutional clients. Tr. 875-876; 880-81 (Koch). Although this explanation is uncontradicted on the record, it was rejected by the Initial Decision as not credible based solely on reading the text of the e-mail. ID at 13-14.

The impact: Despite the interpretation of the ID, it is clear the trader understood the directive as Mr. Koch explained at the hearing. KAM's order was executed in small units, not large blocks which could have caused the illiquid and volatile stock to spike past the limit price set by KAM of $25. Tr. 879 (Koch). The small executions had the exact effect Professor Jarrell testified is typical, a slow laddering up of the price. Tr. 1122 (Jarrell). This in turn drew sellers to the market who could see the transactions but not the limit price (Rule 611) as illustrated by the executions. Exh. R. 36 at 21-26. Selecting the last day of the quarter and patiently waiting until mid afternoon after testing the market was successful: KAM acquired a block of the most difficult to find High Country shares with a last execution or closing price for KAM of $24, just below the projection in the e-mail, and at an overall average price for the day of $20.38. Exh. 278 at 5.

The validity of KAM's technique is confirmed by the undisputed testimony and analysis of Dr. Jarrell and Mr. Schneider. Dr. Jarrell concluded after an extensive analysis that KAM's purchases of High Country shares on September 30, that the purchases were at prices comparable to those paid by other buyers in non-KAM transactions. He cautioned that High Country is so illiquid and has so few transactions that the stock was highly volatile and subject to wild price gyrations he called the "bid-ask" bounce. Tr. 1060-61, 1103-05 (Jarrell). This phenomenon, well documented in the academic literature, means its price tends to bounce between the bid and the ask. *Id.* Nevertheless, analysis of all the available evidence confirmed the comparability of the purchases. Similarly, Mr. Schneider concluded that KAM's purchases on September 30 were in accord with its longstanding investment program. Exh. R. 36 at 37-38; Tr. 988 (Schneider). In sum, KAM acted for the benefit of a longtime client, not to mark the close.

D. KAM's Purchases in December Were Made For Investment Using an Approach and Techniques Tailored To The Market And Stock.

On the last day of December 2009 KAM and Mr. Koch invested the excess cash of Tampsco in shares of High Country, Cheviot and Carver using essentially the same approach successfully employed in September. Exh. R. 39 at 58. Tampsco is another longtime client of the adviser which traces to the beginning of the advisory. Tr. 807-08 (Koch). The economic investment purpose for the transactions is the same as for the September purchases: To move up the share holdings of accounts that had accumulated large cash positions, thereby enhancing returns. Tr. 907-08 (Koch).

Preparation: The end of the year is traditionally a very busy trading day, as Mr. Koch knew (Tr. 861-62 (Koch)) and Mr. Christanell would later attest (Exh. 192). KAM prepared by alerting the trader that it would seek to purchase shares of near impossible to buy High Country

as the year closed in two e-mails, one dated December 23, 2009 (Exh. R. 33) and the other, five days later on December 28. Exh. 186.

The e-mails followed the unsuccessful effort by KAM before Christmas 2009 to acquire a block of Cheviot, using a tactic Mr. Christanell suggested of setting the limit price near the bid. The December 23 e-mail stated in part that "I also will want to move up HCBC the last day of the year before things close down. . . ." The other reiterated this point noting, "I would like to get a closing price in the 20-25 range, but certainly above 20" (Exh. 186), echoing Mr. Koch's September prediction that KAM's last execution would have to be just below TBV if a block was to be acquired.

Monitoring activity on the phone: On December 30 Jeff Christanell and Mr. Koch spoke six times, according to tapes from the Huntleigh system. The Initial Decision considered the December e-mails and the tapes as evidence of intent. If considered in conjunction with all of the evidence they provide insight to the approach used to successfully acquire the blocks of stock on December 31. If heard alone they can be misleading since listening to them is akin to walking in on a conversation at mid-point since the two men clearly understood each other and thus did not feel compelled to explain their statements, at times spoke in sentence fragments, sometimes interrupted each other and at points shift from topic to topic.

The beginning: The conversations began 45 minutes before the market open. KAM had given the firm an order for High Country and reiterated the September strategy: "My parameters are if you need 5,000 shares, do whatever you have to do. I need to get it above 20 . . . 25 I'm happy." The two men agree to seek executions about an hour before the close as in September with Mr. Koch cautioning, "Okay, you do what you need to do to see what the market is and I think you know just go market share 100s. You know . . . I don't want to tell you your job, but

get it up there." Exh. 189. This approach and timing should give KAM the opportunity for a series of small executions at slowly laddering prices caped by its limit order but which will draw sellers to the market as in September.[9]

Other clients: By mid-morning, KAM was considering whether it wanted to acquire other securities with Mr. Koch stating in a 10:55 a.m. conversation that "Fay's [KAM's record keeper] looking into to see what else we want to move up toward the end of the year." Exh. 193. As KAM's record keeper Ms. Heidtbrink tracked the positions of each client and would be in a position to inform Mr. Koch which other clients, in addition to Tampsco, should move up their securities positions because they had excess cash. Tr. 904 (Koch). Later in the conversation Mr. Christanell noted that the "market's coming in a little bit . . . ."

More orders: Less than two hours later KAM gave the trader instructions to purchase shares of Cheviot and Carver. After reviewing the spreads on Cheviot, which were then at $7.20 to $7.48 according to Mr. Christanell, Mr. Koch stated "let's see if by the end of the day you move it around 8, 8 and a quarter . . ." (Exh. 191) a reference to a KAM closing or last execution price of just over $8, but below TBV of $12 to $15 for this stock. Tr. 798, 854 (Koch). Mr. Christanell reported the Carver spread to be $8.10 to $9.05 but stated that there was no volume, no trades. Mr. Koch instructed the trader to buy or as he said at the time "pop that one" (Exh. 191), later in the day at the bid, $9.05, an approach which would clearly result in an execution well below the TBV of $20 for the stock. *Id.*

Cautioning the trader again to use small executions: About one hour before the market close, Mr. Koch called to see if KAM's orders were being executed. Although the men agreed earlier that executions would begin about the time of the call, Mr. Christanell reported that "I

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[9] Later in the same conversation Messrs. Koch and Christanell speculate about the possible appearance of a trader who might act to push the price up if they begin their executions to early in the day. This discussion is detailed in Respondents' Proposed Findings at 66-67.

haven't done anything yet. I was just kind of waiting here, you know before I . . ." Mr. Koch cautioned the trader again to use small executions: "You know, I'd start at the 100, 200 share increment, depending on how far it moves. I think since it trades little [referring to Cheviot] you'll . . ." Exh. 190. Mr. Christanell recounted his earlier orders for High Country and Cheviot but stated he only wanted to buy 300 shares of Carver despite the fact he had entered an order in Huntleigh's system for 1,000 shares with a limit price of $9.05. Exh. R. 39 at 36. While he did not specify the reason for the small purchase, Mr. Koch agreed, apparently because there had been no trades. Exh. 191.

Go early: Twenty-one minutes before the close Mr. Koch spoke to the trader for the last time before the end of the trading day. The conversation was brief. Mr. Christanell was apparently quite busy. Mr. Koch urged him "Yeah, go ahead, go early." Exh. 188. Unfortunately the trader failed to head the directive.

After closing assessment: Mr. Christanell made an error: For Cheviot and Carver the trading strategy was successful, but not completely for High Country. Cheviot, the stock which could not be acquired earlier in the month with a limit order near the bid, was readily available using the September strategy. KAM had sought a block of 5,000 shares. It purchased 6,600 by the end of the day – Mr. Christanell revised the limit order about 4 minutes prior to the close, increasing it from the KAM approved 5,000 shares to 7,000. Exh. R. 39 at 31. KAM did not set the market closing price. *Id.* While amending the limit order had not been authorized, Mr. Koch ratified the action in the post closing review.

The strategy employed with respect to Carver – recognizing that there were few executions in the market and adjusting expectations to a small purchase – was successful. KAM

bought 300 shares at the ask of $9.05 as suggested by Mr. Christanell. KAM did not set the market closing price. Exh. R. 39 at 37.

Despite its planning, KAM failed to acquire the 5,000 share block of High Country it sought, receiving only a partial fill of 3,600 shares. Mr. Christanell apologized noting "I'm sorry, it closed at 17.50. I know you wanted it higher, and I tried." Indeed, Mr. Koch had theorized in their earlier conversations that the price would have to reach $20 or more as in September for KAM to acquire the shares it sought. Mr. Christanell essentially ratified this fact, explaining: "The main thing with that one is it's on the bulletin board and you just can't put an order out to take it, you know like you could in another market to go buy 5,000 on the market and go boom, boom, boom you're done like that . . . ." Later he amplified this thought stating: "you have to hit every venue, bait them for stock, and then they keep coming back with more . . . ," and he ran out of time.

The execution times verify Mr. Christanell's explanation: On September 30 he routed KAM's order to the street so its first execution after revising the limit order to $25 was at 14:15, almost 45 minutes before the market close. In contrast, on December 31 he delayed obtaining the first execution until just about 4 minutes before the close. At that point there was no time for KAM's slow laddering approach to work.

Professor Jarrell and Mr. Schneider confirmed the validity of KAM's approach. Professor Jarrell's analysis established that there is no evidence of manipulation as to the purchases of Cheviot and Carver on December 31, 2009. KAM did not set the closing price for either security on that day. The purchases of Cheviot and Carver were at prices comparable to those paid by other traders in non-KAM transactions. Mr. Schneider confirmed that the purchases of Cheviot

and Carver were made in accord with KAM's longstanding investment program and its historical transactions. Tr. 944, 1003-04 (Schneider).

Professor Jarrell's analysis also confirmed that KAM did not mark the close in purchasing shares of High Country on December 31. The illiquidity and extreme volatility of the stock, which causes its price to bounce between the bid and ask, precluded the type of analysis done for Cheviot and Carver. Tr. 1079 (Jarrell). Nevertheless, he was able to confirm that the purchases by KAM were made at prices comparable to those paid by other traders in transactions which did not involve the adviser. Tr. 1117 (Jarrell). Again, Mr. Schneider's analysis confirmed that the purchases were in accord with KAM's investment policies and historical transactions. Exh. R036 at 9. In the end however, it is KAM's clients who ultimately verified the investment purpose of the acquisitions -- there is no evidence that either sold the shares even after learning of the OIP.[10]

E. KAM and Mr. Koch Had No Motive to Manipulate.

KAM and Mr. Koch had every motive to faithfully execute their obligations to longstanding clients and none to act contrary to those interests. The incredible success of the firm over the years which an average return on equity of 42% even through the market crisis, the longstanding personal relations of Mr. Koch with KAM's clients and his years of service with unquestioned integrity all compel the conclusion that firm clients were faithfully served here.

Claims of a motive to manipulate fail. First, the allegation in the OIP that KAM and Mr. Koch acted to enhance the monthly brokerage statements of their clients is simply wrong. The record demonstrates that the average KAM client held about $1.2 million in securities and cash. Tr. 796 (Koch). Assuming the Division's approach to calculating the increased value in each

[10] Mrs. Smith had passed away by the time the OIP was issued. Her executor grandson, an investment adviser in California, took over the estate after Mr. Koch resigned as co-executor. There is no evidence indicating that the shares were sold.

account is correct – and it is not – the typical KAM account holder would have seen an increase on his or her September brokerage statement of about 3%. In December the increase would have been less than 1%.[11] Those incremental increases in value are so small that, in probability, they would not have been noticed by the typical client.

The Division's contention that the proper manner to assess this point is to total the value of all advisory and non-advisory client accounts and determine the gross amount of the increase does not speak to the question of motive. No KAM clients would have seen such a tabulation. Exhibit 311. Thus, by definition it cannot constitute a motive to manipulate.

The Division's alternative motive also fails. Although not charged in the OIP and thus outside case, the Division now claims that KAM and Mr. Koch manipulated the share prices to enhance the advisory fees charged. Again, the claim fails. .

The Division's calculation of the claimed fee increase is wrong as previously demonstrated. Perhaps more importantly, not only is the sum immaterial, it ignores the fact that KAM voluntarily waived more advisory fees each month than the claimed increase. The evidence demonstrates that since 1996, KAM has voluntarily waived about $234,193 in fees for accounts it determined did not perform as well as expected. In 2009 the firm waived $32,086 in fees – more than the claimed increase. It more than strains credibility to assert that KAM and Mr. Koch disregarded their obligations, longstanding friendships and reputations to manipulate the share price to increase their fees by ***less*** than the amount they voluntarily waived. Claimed motive is no motive and there was no manipulation.

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[11] These figures were tabulated using the Division's exhibits and methodology. A calculation can be produced for examination if necessary.

III. NO ADDITIONAL SANCTIONS ARE WARRANTED IF A VIOLATION IS FOUND SINCE THE FINDING WILL PRECLUDE A REOCCURRENCE AND RESPONDENTS ARE OUT OF THE BUSINESS.

The purpose of sanctions is to punish wrongful conduct while preventing its replication in the future. As the Initial Decision notes, key considerations in this regard are the egregiousness of the actions, whether they are recurrent or isolated, the degree of scienter, the assurances against future violations and recognition of the wrongful conduct and opportunity for a reoccurrence in the future. Here these considerations compel the conclusion that the imposition of sanctions is not warranted and would be overly punitive. *See, e.g.*, *Steadman v. SEC*, 450 U.S. 91 (1981).

First, the entry of a cease and desist order is not warranted. The imposition of such an order is typically made in view of the multi-factor test in *Steadman.* The essence of those factors is the need to protect the public from a replication of the wrongful conduct, measured in terms of the nature of the offense and the opportunity for more wrongful conduct in the future.

KAM and Mr. Koch have an unblemished record of years of service to firm clients. There is no pattern of wrongful conduct, just four purchases on two days over four months. There is no indication that such conduct occurred prior to the isolated dates here or after. Likewise, the violations are not egregious. Rather, the purchases involved only conduct which in and of itself is lawful, was within the investment program of the firm and occurred because the adviser was trying to implement that program under difficult circumstances.

Perhaps more importantly, there is little likelihood of reoccurrence. KAM and Mr. Koch currently have no advisory clients. They voluntarily requested that each client leave after this proceeding was initiated. The ADV for the firm reflects that fact that Mr. Koch retired. While he could re-enter the business it would only be with the affirmation of state officials – KAM is not

eligible to continue registration with the Commission under Dodd-Frank – who would be obligated to supervise him. Thus there is no need for such an order.

The fact that KAM and Mr. Koch have contested the charges here that does not suggest as the Initial Decision concluded, to the contrary. Not only did they have this right, but under the circumstances it was wholly appropriate. As the record demonstrates, at a minimum there are substantial questions about the actions taken and the charges. At the same time, Mr. Koch's career and deep respect for the rule of law – evidenced at least in part by the foundation he created with his personal funds to educate students about this country – demonstrates that he would respect and abide by the ruling. Indeed, in view of his deep respect for the law any adverse ruling here would be more than sufficient punishment and would constitute an effective deterrent to any replication of those actions. Thus a cease and desist order, bar, or penalty is not necessary. *SEC v. Perez*, 2011 WL 5597331, at *5 (S.D. Fla. Nov. 17, 2011) (court declined to impose an injunction or sanction after finding defendant engaged in insider trading based on his established respect for the court's ruling). In the end, the imposition of any sanction in addition to an adverse ruling would simply be punitive and thus unnecessary.

CONCLUSION

The question posed by this case, as stated at the beginning, is whether an investment adviser making client purchases to move up their securities holdings and reduce cash by placing limit orders for highly illiquid securities and directing small executions that slowly ladder up the price to draw sellers into the market so a block of stock can be acquired and give the adviser a closing price within the limits of its investment program violated the antifraud provisions.

As stated at the beginning, the answer can only be determined after a careful examination of all the evidence. The totality of that evidence demonstrates:

- That KAM and Mr. Koch acted here to invest client funds for the long term in accord with a highly successful investment program;

- That those investments were made using market dynamics and long-established trading and investment techniques;

- That KAM and Mr. Koch did not engage in manipulation, marking the close or any other improper conduct, according to the undisputed analysis of Professor Jarrell;

- That the purchases made where were wholly consistent with KAM's longstanding investment policies and practices, according to the undisputed analysis of Mr. Schneider;

- That each purchase transaction received best execution in the marketplace; and

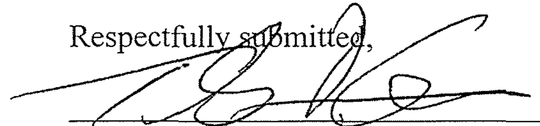
- Most importantly, each investment was confirmed by the fact that the clients continued to hold the securities and there is no evidence they sold.

Thus the totality of the evidence demonstrates that KAM and Mr. Koch acted as an investment adviser should – solely for the benefit of the clients. The only way to conclude otherwise is to credit a non-motive as motive, read three e-mails out of context and listen to the recordings without placing the statements in the context of the markets, transactions and the fact record here, which would be wholly inappropriate.

In the end, the answer to the question is that KAM and Mr. Koch acted as an investment adviser should – in the best interest of the clients. Respectfully, this proceeding should be dismissed.

Dated: September 10, 2012

Respectfully submitted,



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