UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISORS ACT OF 1940

Admin. Proc. File No. 3-14536

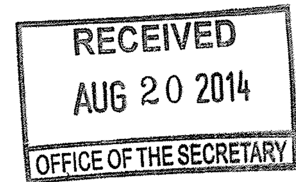
In the Matter of

MONTFORD AND COMPANY, INC.,
d/b/a MONTFORD ASSOCIATES,

and

ERNEST V. MONTFORD, SR.,

Respondents.

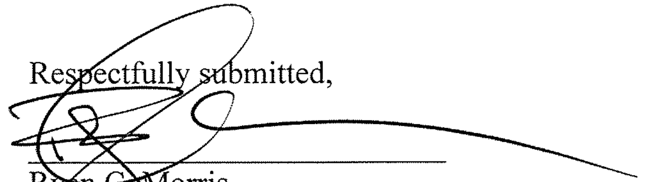


RESPONDENTS' MOTION TO STAY THE COMMISSION'S SANCTIONS ORDER PENDING JUDICIAL REVIEW

Respondents Montford and Company, Inc. and Ernest V. Montford, Sr., by and through undersigned counsel, move under Rule of Practice 401 to stay the Commission's May 2, 2014 sanctions order pending disposition of their petition for review of that order by the U.S. Court of Appeals for the District of Columbia Circuit. In support of their motion, Respondents submit the attached memorandum of points and authorities.

Dated: August 19, 2014

Respectfully submitted,



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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF RESPONDENTS' MOTION TO STAY THE COMMISSION'S SANCTIONS ORDER PENDING JUDICIAL REVIEW

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INTRODUCTION

Respondents Montford and Company, Inc. and Ernest V. Montford, Sr., by and through undersigned counsel, move under Rule of Practice 401 to stay the Commission's May 2, 2014 sanctions order (the "Order"). Respondents have petitioned the U.S. Court of Appeals for the District of Columbia Circuit to review the Commission's Order. Absent a stay pending their appeal of the Commission's Order, Respondents would be irreparably harmed if required to pay the excessive sums imposed by the Commission, amounts that are an order of magnitude greater than the amounts requested by the Division of Enforcement ("Division"). Respondent Montford and Company, Inc. ("Montford Associates") is no longer an operating business, and Respondent Ernest V. Montford, Sr. ("Mr. Montford") is already in dire financial straits. The $860,000 sanction imposed on him would be ruinous. Moreover, Respondents are likely to prevail on the issues of first impression raised in this case and in overturning the sanctions against them, which are inconsistent with governing standards and statutory factors. No other party will suffer any harm from a brief delay in the collection of the disgorgement and civil penalties awarded against Respondents (to the extent there is any), and the public interest is best served by allowing Respondents to litigate the important issues here before crippling sanctions may be imposed on them. Respondents respectfully request that the Commission's Order be stayed until the D.C. Circuit issues a mandate resolving Respondents' petition.

BACKGROUND

During the relevant time period, Montford Associates was a registered investment adviser chartered in Georgia. It provided fee-based investment advisory services to institutional investors. Mr. Montford was the owner, President, and CEO of Montford Associates.

On September 7, 2011, the Commission instituted administrative and cease-and-desist proceedings against Respondents pursuant to Sections 203(e) and 203(k) of the Investment Ad-

visers Act of 1940. *See In re Montford & Co.*, Release No. IA-3273, 2011 WL 3916057 (Sept. 7, 2011). The Division alleged that Respondents received fees from SJK Investment Management, LLC ("SJK"), a registered investment advisor, for promoting SJK without disclosing those fees to clients. The Division noted that SJK and its principal, Stanley Kowalewski, had been charged with securities fraud in early 2011 as a result of, among other things, Kowalewski's misappropriation of funds invested with SJK, but the Division did not suggest that Respondents were aware of or complicit in these schemes. *See id.* at *3 n.1. The Division alleged that Montford Associates' Forms ADV filed in 2009 and 2010 contained inaccuracies regarding Respondents' independence and did not disclose Respondents' acceptance of any fees. The Division alleged that these representations were inaccurate because Montford Associates received two payments totaling $210,000 from SJK in 2010. The Division asserted that these actions resulted in violations of Sections 206(1) and 206(2) of the Advisers Act.

At a prehearing conference on October 3, 2011, Respondents moved to dismiss the proceeding as time-barred under 15 U.S.C. § 78d-5 because the Division failed to institute the proceeding within 180 days after issuing a Wells Notice to Respondents. *See* 15 U.S.C. § 78d-5(a)(1) ("Not later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action."). The Administrative Law Judge ("ALJ") denied that motion, and then denied an application for interlocutory appeal of the denial. The Commission issued an order denying a suggestion for interlocutory review on November 9, 2011.

In their answer and prehearing brief, Respondents denied that the funds they accepted from SJK were in exchange for client referrals, demonstrating that the funds were instead for

consulting and set-up services related to SJK's launch. They further showed that they were unaware of any fraud on SJK's part, and were instead fooled completely by Kowalewski's scheme. Respondents also reasserted that the proceedings were untimely under 15 U.S.C. § 78d-5.

The ALJ held a hearing on November 7, 2011, and issued an Initial Decision on April 20, 2012. *In re Montford & Co., Inc.*, Release No. ID-457, 2012 WL 1377372 (ALJ Apr. 20, 2012). She first declined to reconsider her denial of Respondents' motion to dismiss. *Id.* at *11. She then found that Respondents violated Sections 204, 206, and 207 of the Advisers Act. *Id.* at *12–15. The ALJ imposed a bar order, a cease-and-desist order, a civil penalty, and disgorgement. Despite Mr. Montford's long and upstanding career and his lack of knowledge of Kowalewski's fraud, the ALJ imposed penalties that were an order of magnitude higher than were even requested by the Division. *See id.* at *15, *21. Respondents petitioned the Commission to review the ALJ decision.

On May 2, 2014, the Commission issued its Order and accompanying opinion on Respondents' petition. *See In re Montford & Co., Inc.*, Release No. IA-3829, 2014 WL 1744130 (May 2, 2014). The Commission found that the proceeding was not time-barred by 15 U.S.C. § 78d-5, because that provision "does not impose a limit on the Commission's jurisdiction to bring these administrative proceedings." *Id.* at *9. The Commission also upheld the ALJ's determination that Respondents violated Sections 204, 206, and 207 of the Advisers Act. *Id.* at *13–18. Like the ALJ, the Commission imposed a bar order, a cease-and-desist order, disgorgement, and civil penalties. Respondents were ordered to jointly and severally disgorge $210,000 plus prejudgment interest. The civil penalties were set at $150,000 for Mr. Montford and $500,000 for Montford Associates. *Id.* at *27.

On June 27, 2014, Respondents petitioned the D.C. Circuit to review the Commission's decision under 15 U.S.C. § 78y. *Montford & Co., Inc. v. U.S. Sec. & Exchange Comm'n*, No. 14-1126 (D.C. Cir. docketed June 27, 2014). That action is currently pending, and the court has not yet set a briefing schedule.

ARGUMENT

The Commission should stay its Order while the D.C. Circuit considers Respondents' petition for review because Respondents are likely to succeed in vacating the Order and they will suffer substantial, irreparable harm absent a stay. At a minimum, the Commission should stay the disgorgement order and civil penalties pending determination of the petition. *See, e.g.*, *In re Koch*, Release No. IA-3860, 2014 WL 2800778, at *3 (June 20, 2014).

Motions to stay Commission orders are governed by Rule of Practice 401. *In re VanCook*, Release No. IC-28644, 2009 WL 605322, at *1 (Mar. 10, 2009); *see* 17 C.F.R. § 201.401(c) ("A motion for a stay of a Commission order may be made by any person aggrieved thereby who would be entitled to review in a federal court of appeals.").[1] In evaluating a stay request, the Commission considers four factors: (i) whether the party seeking the stay is likely to suffer irreparable injury if the stay is not granted; (ii) whether that party is likely to prevail on appeal; (iii) whether any other party is likely to suffer substantial harm if the stay is granted; and (iv) whether the stay will serve the public interest. *In re Koch*, 2014 WL 2800778, at *1. Here, each of these factors favors a stay.

[1] There is no question that Respondents, as the parties sanctioned by the Order, are "aggrieved thereby," such that they may seek review in the Court of Appeals and, in turn, request a stay from the Commission. *E.g.*, *In re Koch*, 2014 WL 2800778, at *1 (considering a stay request from a sanctioned party); *see also NASD, Inc. v. SEC*, 431 F.3d 803, 806 (D.C. Cir. 2005) (noting that parties subject to final Commission disciplinary action may seek appellate review under 15 U.S.C. § 78y(a)).

I. Respondents Will Be Irreparably Harmed Absent A Stay.

Respondents will plainly suffer irreparable harm absent a stay. Montford Associates is already defunct, and the immediate enforcement of the $210,000 disgorgement order and the $650,000 in total civil penalties would be ruinous for Mr. Montford, who is already in dire financial straits. *See* Ex. A (Montford Decl.) ¶¶ 3, 10. Having lost a substantial portion of his retirement funds to Kowalewski's fraud, Mr. Montford is now living off of Social Security and a small pension from a prior employer, which do not even cover his monthly expenses. *Id.* ¶¶ 4–5. He owns two residential properties, one of which is already subject to imminent foreclosure, because he has been unable to make the mortgage payments for several months, and the other of which he is currently attempting to sell. *Id.* ¶ 7. Even if he succeeds in selling that property, he will not be able to gather sufficient funds to pay the sanctions. *Id.* ¶ 8. In fact, he has been forced to borrow money from relatives in an attempt to make ends meet. *Id.* ¶ 9. In sum, immediate enforcement of the sanctions would be crippling. *See Doran v. Salem Inn, Inc.*, 422 U.S. 922, 932 (1975) (noting that the risk of bankruptcy "meets the [irreparable harm] standards for granting interim relief, for otherwise a favorable final judgment might well be useless"); *Church of Scientology of Cal. v. United States*, 920 F.2d 1481, 1489 (9th Cir. 1990) (financial penalties that would cause "financial ruin" establish irreparable harm); *Church of Scientology of Celebrity Ctr. v. Egger*, 539 F. Supp. 491, 495 (D.D.C. 1982) (same).

II. Respondents Are Likely To Prevail On Appeal.

Respondents are likely to prevail before the D.C. Circuit, including on their challenge to the Commission's authority to institute the proceedings below and the imposition of sanctions against them. First, the Commission erred in holding that 15 U.S.C. § 78d-5 does not create a jurisdictional bar to this action. That provision — entitled "Deadline for completing enforce-

ment investigations and compliance examinations and inspections" — sets a concrete deadline for the commencement of an action:

> Not later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action.

15 U.S.C. § 78d-5(a)(1). There is an exception that would allow the deadline to be extended for an additional 180 days "for certain complex actions," but only if the Division takes certain steps. *Id.* § 78d-5(a)(2). Here, the proceedings were commenced 187 days after Respondents received the Wells Notice, *see* Order, 2014 WL 1744130, at *9, and the complex-action exception was not properly invoked. The proceedings against Respondents were untimely.

Section 78d-5's language is mandatory: the staff "shall" file an action, or declare that it will not do so. *See Allied Pilots Ass'n v. PBGC*, 334 F.3d 93, 98 (D.C. Cir. 2003) (noting that "shall" is a command); *FTC v. Tarriff*, 557 F. Supp. 2d 92, 95 (D.D.C. 2008) ("'shall' is 'used in laws, regulations, or directives to express what is mandatory'" (citation omitted)), *aff'd*, 584 F.3d 1088 (D.C. Cir. 2009). The statute thus sets forth a certain process that the staff must follow. In doing so, it mirrors the language of other provisions that have been held to create jurisdictional bars for untimely actions. *See, e.g.*, *Mohasco Corp. v. Silver*, 447 U.S. 807, 815–17 (1980) (where a Civil Rights Act provision required "that a 'charge under this section shall be filed within one hundred and eighty days after the alleged unlawful employment practice occurred,'" and no exceptions applied, the district court lacked jurisdiction (quoting 42 U.S.C. § 2000e-5(e)).[2] And, unlike certain provisions that use mandatory language but fail to specify any con-

[2] Notably, the statute at issue in *Mohasco* did not say that if a charge was not filed within 180 days, the court would lack jurisdiction, *see* 42 U.S.C. § 2000e-5(e)(1); that was implicit in the statute's mandatory language.

sequences for noncompliance, *see Brock v. Pierce Cnty.*, 476 U.S. 253, 259–61 (1986), Section 78d-5 does specify consequences: unless the staff commences an action within 180 days of the Wells Notice, it must seek an extension or explain its failure to act. *Cf. Bustamante v. Napolitano*, 582 F.3d 403, 409 (2d Cir. 2009) (120-day deadline for Citizenship and Immigration Services to act on a naturalization application was jurisdictional where it "'require[d] an agency . . . to act within a particular time period and specifie[d] a consequence for failure to comply with the provision'" (quoting *Brock*, 476 U.S. at 259)). The plain meaning of § 78d-5 requires the staff to act within 180 days, or forfeit the opportunity to do so (and explain why). *See id.* at 406 ("'[S]tatutory analysis necessarily begins with the plain meaning of a law's text and, absent ambiguity, will generally end there.'" (citation omitted)).

Notwithstanding § 78d-5's clear terms, the Commission rejected Respondents' time-bar argument in part because, in the Commission's view, reading § 78d-5 to limit the Commission's ability to bring an action would conflict with the existing five-year statute of limitations for enforcement actions set forth in 28 U.S.C. § 2462. *See* Order, 2014 WL 1744130, at *11. But the two provisions fit comfortably together: Section 78d-5 governs how long the Commission has to act after issuing a Wells Notice, whereas § 2462 is a classic statute of limitations that begins to run from "the date when the claim first accrued." 28 U.S.C. § 2462. The two provisions also have different functions. Like any statute of limitations, § 2462 serves the general purpose of repose, *see Gabelli v. SEC*, 133 S. Ct. 1216, 1221 (2013), while § 78d-5 serves the dual purposes of promoting swift agency action and protecting the targets of Commission investigations from prolonged, disruptive investigations. Indeed, § 78d-5 is specific to the Commission and its enforcement proceedings, whereas § 2462 is "a catch-all statute of limitations," *FEC v. Nat'l Republican Senatorial Comm.*, 877 F. Supp. 15, 17 (D.D.C. 1995), that applies to *any* "action, suit

or proceeding for the enforcement of any civil fine, penalty, or forfeiture" that is not subject to a specific limitations period under another federal statute, 28 U.S.C. § 2462. Consequently, there is no conflict between the time-bars in these two provisions; they are complementary, not contradictory. The Commission erred in holding that § 78d-5 did not bar these proceedings.

The Commission also erred in concluding, in the alternative, that the 180-day deadline was properly extended under § 78d-5(a)(2). To extend the deadline, the Division's Director (or the Director's designee) must "determine[] that a particular enforcement investigation is sufficiently complex" that a filing decision cannot be made within 180 days, and then, "after providing notice to the Chairman . . . , [it may] extend such deadline as needed for one additional 180-day period." 15 U.S.C. § 78d-5(a)(2). Here, the deadline was extended, but the complexity determination was never made.

Nowhere does the record show that the Director or a designee made the predicate complexity determination. Instead, the ALJ declared that one could "deduce" that it had been made from the fact that the deadline was extended. *See* Order, 2014 WL 1744130, at *10. The Commission similarly concluded that the fact of the extension was itself sufficient to establish compliance with § 78d-5(a)(2), asserting that the statute "commits the decision to extend the deadline to the sole discretion of the Division Director," and "[t]here is no statutory requirement that the Director articulate the reasoning or basis for granting the extension." *Id.* at *13. First, whether or not the Director's reasoning is subject to disclosure and challenge, the Director must still make the determination in the first place. Here, nothing in the record suggests that the Director (or a designee) did so. And, second, the statute explicitly provides that the Director (or a designee) must give "notice" to the Chairman.

Moreover, if the Commission could always "deduce" that the complexity determination had been made from the fact that the deadline was extended, an explicit requirement of the statute would be rendered superfluous. *See Duncan v. Walker*, 533 U.S. 167, 174 (2001) ("every clause and word of a statute" should be given effect); *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment."). If Congress intended to achieve the result that the Commission has produced, it could have written the statute simply to require that the Director decide to extend the deadline. Instead, Congress mandated that the deadline may be extended only "if the Director . . . or the Director's designee determines that [the] investigation is sufficiently complex." 15 U.S.C. § 78d-5(a)(2). Because there is undisputedly no record evidence showing that this occurred here, the Commission erred in finding that the statute's requirements were satisfied.

The Commission also erred in imposing severe sanctions on a first-time violator who was himself a victim of, rather than an accomplice to, the underlying fraudulent conduct. Mr. Montford invested his own retirement funds, totaling over $200,000, with Kowalewski and SJK. Those funds were wiped out by Kowalewski's misconduct. Mr. Montford also had a long and successful career as an investment advisor, which was marred only by this episode, in which he was duped by Kowalewski. That is presumably why the Division asked the ALJ to impose monetary sanctions of just $25,000 on both Mr. Montford and Montford Associates. The ALJ, however, imposed fines of $150,000 and $500,000, respectively — six and twenty times more than the Division recommended. The Commission upheld those amounts, declaring Respondents' conduct "particularly egregious." The Commission was wrong to brush aside Montford's long, otherwise-unblemished career and his role as a victim in Kowalewski's scheme. In fact, the

Commission said that the sanctions were warranted in part because Mr. Montford accepted benefits from SJK, including "free investment management services for his IRA" — disregarding that it was Mr. Montford's receipt of those "services" that led to his own retirement funds being wiped out.[3] The Commission simply failed to apply the statutory factors that govern the imposition of civil penalties. *See* 15 U.S.C. § 80b-3(i)(3) (requiring the Commission to consider, among other things, that the respondent has never previously been found to have violated the securities laws or rules).

The Commission's disgorgement order was also unjustified. "The touchstone of a disgorgement calculation is identifying a causal link between the illegal activity and the profit sought to be disgorged." *SEC. v. UNIOIL*, 951 F.2d 1304, 1306 (D.C. Cir. 1991) (per curiam) (Edwards, J., concurring); *see also Zacharias v. SEC*, 569 F.3d 458, 471–72 (D.C. Cir. 2009). In other words, "the [Commission] may exercise its equitable power only over property causally related to the wrongdoing," and "disgorgement may not be used punitively." *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). "Therefore, the SEC generally must distinguish between legally and illegally obtained profits." *Id.* No such causal connection was established here. The money Respondents accepted from SJK was not compensation for client referrals or for any advice given to any client. And the violations the Commission found stemmed not from Respondents' receipt of that money, but rather from their failure to disclose the payments. *See* Order, 2014 WL 1744130, at *13–17. Of course, the payments cannot have been

[3] In disregarding Mr. Montford's losses as a result of SJK's fraud, the Commission noted that "'[f]inancial loss to a wrongdoer as a result of his wrongdoing does not mitigate the gravity of his conduct,'" Order, 2014 WL 1744130, at *20 (quoting *In re Kornman*, Release No. IA-2840, 2009 WL 367635, at *9 (Feb. 13, 2009) (alteration in original), but did not attempt to explain how Mr. Montford could have lost his retirement fund "as a result of" the disclosure violations at issue in this case. Nor could it, since the record reveals no causal connection between the two.

caused by Respondents' subsequent failure to disclose them. Thus, the "touchstone" of disgorgement — causation — is absent here.

For the foregoing reasons, among others, Respondents are likely to prevail on the merits before the Court of Appeals.

III. No Other Party Will Be Harmed By A Stay, Which Serves The Public Interest.

No other party is likely to suffer any harm if the stay is granted. Montford Associates is no longer an operating business and Mr. Montford is not, of course, engaged in any investment advising activity. *See id.* ¶¶ 1–3. He has no intention of doing so in the future, even if a stay is granted. *Id.* ¶ 1. Accordingly, there is no risk that, absent the bar order and the cease-and-desist order, he will somehow harm a client or violate the securities laws. *Cf. In re Clifton*, Release No. 33-9465, 2013 WL 5553865, at *4 (Oct. 9, 2013). Simply put, his securities career is over regardless of the eventual outcome of this proceeding. And, of course, no party will be substantially harmed by a brief delay in the collection of the disgorgement order and the civil penalties. If Respondents do not prevail on appeal, the funds will be paid. And if Respondents do prevail — as is likely — those funds will never become available anyway. In either event, a stay of the financial sanctions will cause no substantial harm to the Commission or any other party.

The public interest favors a stay as well. As described above, there is no risk of harm to the Commission or any other party from a stay here. Further, Respondents have raised significant issues regarding the correctness of the Commission's decision and its power to act against them at all. As the Commission acknowledged, this proceeding was the first opportunity the Commission has had to construe § 78d-5. *See* Order, 2014 WL 1744130, at *10. And no federal court of appeals has yet interpreted or applied that provision. The public interest favors a full and fair opportunity for judicial review of these novel issues before crippling sanctions are imposed on Respondents, causing irreparable harm to Mr. Montford. *See Citifinancial, Inc. v.*

Lightner, No. 06-145, 2007 WL 3088087, at *4 (N.D.W. Va. Oct. 22, 2007) (noting that the public interest "generally will benefit from having an issue of possible first impression resolved" by the court of appeals); *Territorial Ct. of Virgin Islands v. Richards*, 674 F. Supp. 180, 183 (D.V.I. 1987) (granting a stay pending appeal in part because the public interest "weigh[s] heavily" in favor of "maintaining the *status quo* until the Circuit addresses this case of first impression"); *cf. Hatfill v. Mukasey*, 539 F. Supp. 2d 96, 106 (D.D.C. 2008) (the public interest favors the "opportunity [for a party] to have his day in Court").

* * *

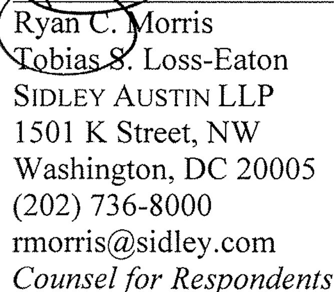
In sum, because Respondents are likely to prevail on appeal and will suffer irreparable injury absent a stay, the Order should be stayed pending disposition of Respondents' petition to the D.C. Circuit. At a minimum, the Commission should exercise its discretion to stay the disgorgement order and civil penalties. *See, e.g.*, *In re Koch*, 2014 WL 2800778, at *3; *In re Pierce*, Release No. 33-9598, 2014 WL 2582832, at *1 (June 9, 2014); *In re Rizek*, Release No. 34-41972, 1999 WL 955890, at *2 (Oct. 1, 1999).

CONCLUSION

For the foregoing reasons, the Commission should grant this motion and stay the May 2, 2014 Order imposing sanctions on Respondents until the U.S. Court of Appeals for the District of Columbia Circuit disposes of Respondents' pending petition for review.

Dated: August 19, 2014

Respectfully submitted,



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