HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	
JOHN THOMAS CAPITAL MANAGMENT GROUP LLC d/b/a PATRIOT28 LLC,	:	File No. 3-15255
	:	
GEORGE R. JARKESY, JR.,	:	
	:	
JOHN THOMAS FINANCIAL, INC., and	:	
	:	
ANASTASIOS "TOMMY" BELESIS,	:	
	:	
Respondents.	:	

RESPONDENTS' RESPONSE TO ADMINISTRATIVE PROCEEDINGS ORDER DATED MARCH 14, 2018

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Counsel for:
John Thomas Capital Management Group d/b/a Patriot28 LLC and George Jarkesy, Jr

Respondents John Thomas Capital Management d/b/a Patriot28 LLC ("JTCM") and George Jarkesy ("Jarkesy") (collectively "Respondents"), submit this, their Response to Administrative Proceedings Order Dated March 14, 2018 ("Order"), requesting additional evidence and argument regarding offset, and respectfully show as follows:

Preliminary Statement

Subsequent to the Commission's initiation of the administrative proceeding against Respondents, on September 16, 2013, Paul F. Rodney, derivatively on behalf of the limited partners of Patriot Bridge and Opportunity Fund LP I, and later Edwin Debus, derivatively on behalf of the limited partners of Patriot Bridge and Opportunity Fund LP II, brought suit against Respondents amongst others in Harris County, Texas—Cause No. 2013-54408 (the "Related Investor Action").[1] Plaintiffs in the Related Investor Action alleged facts and claims that mirror those advanced by the Division in this enforcement. The plaintiffs also brought claims not available to the Commission of (1) breach of fiduciary duty, (2) waste, (3) negligence, (4) breach of contract, and specifically sought restitution and disgorgement of all monies paid on behalf of investors.

Between July 20, 2015, and October 1, 2015, the parties settled the Related Investor Action for $2,050,000, of which $500,000 was contributed by Respondents. Subsequently, on February 3, 2017, after hearing, the Texas court signed orders (1) giving final approval of the settlement; (2) establishing a Settlement Fund and distribution procedures for the Settlement Proceeds; and (3) dismissing the Related Investor Action.

[1] A Copy of the Second Amended Petition filed in the Related Investor Action (the "RIA Petition") is attached to the Division of Enforcement's Opposition to Respondents' January 5, 2018 Submission Opposing Ratification, dated January 19, 2018.

In their Response to the Commission's November 30, 2017, Order Asserting Ratification of Prior Appointment of Administrative Law Judges, Respondents argued their entitlement to offset of the disgorgement award ordered by Administrative Law Judge ("ALJ") Foelak in this action. In the resulting Order ALJ Foelak requested additional submissions regarding (1) why Respondents should be credited for settlement payments made by MFR or JTF/Belesis; (2) more detail concerning the basis of the related investor lawsuit leading to the settlement for which Respondents seek offset; (3) "the extent to which the settlement amount is attributable to the misconduct underlying the [undersigned's] disgorgement order; and (4) whether settlement payments have been made.

Arguments and Authorities

A. Disgorgement is Subject to Penalty Limits

The Commission can no longer seek disgorgement and penalty as separate remedies in excess of penalty limits, based upon the decision of the U.S. Supreme Court in *Kokesh v. S.E.C.*, *SEC*, 137 S. Ct. 1635 (2017). Although—as the Division points out—the federal securities statutes authorize seeking disgorgement as a separate remedy from a penalty in administrative proceedings, the Supreme Court has now determined—upon analyzing the Commission's practices and the arguments of its counsel—that the way the *SEC* uses disgorgement, *it is a penalty*. Because the SEC does not use disgorgement awards as restitution to compensate those harmed by the respective securities violators, the Supreme Court's determination that SEC disgorgement is a penalty now subjects that remedy to the statutory limits on penalty awards.

The Order recites the ALJ's penalty award from the Initial Decision:

> "a third-tier civil penalty of $450,000 imposed jointly and severally on JTCM and Jarkesy, as authorized by Sections 8A of the Securities Act, 21B of the Exchange Act, 203(i) of the Advisers Act, and 9(d) of the Investment Company Act. *Id.* at *93-97. The applicable maximum third-tier penalty for each violative act or omission was $150,000; in calculating the $450,000 penalty, the [Initial Decision] considered the violations as three courses of action..."

(Order, pg. 3). The maximum third-tier penalty for the "three units of violation" found in the Initial Decision, at the statutory limit, is $450,000. *See* 17 C.F.R. § 201.1001 (maximum third-tier penalty is $150,000 for natural persons per unit of violation for each unit occurring between March 4, 2009 and March 5, 2013); *accord In re. John Thomas Cap. Mgmt. Grp. LLC*, Initial Decision Rel. No. 693, 2014 WL 5304908, at *31 (Oct. 17, 2014). Neither the ALJ nor the Commission can impose a penalty in excess of that amount by adding on an additional penalty with another name. Presumably the Commission could allocate an award between "penalty" and "disgorgement" within the statutory limits, but monetary awards cannot exceed the statutory limits for penalties.

The limits on disgorgement dictated by the Supreme Court and the limits on penalties dictated by Congress are dispositive and preclude the imposition of any monetary remedy in excess of $450,000 jointly or severally against the Respondents, by whatever name they are called.

B. Respondents Must Be Credited for Their Contributions to Settle the Related Investor Action.

The basis of the Related Investor Action is the same as this proceeding. ALJ Foelak identified the following as the basis for the disgorgement award: "[t]he violations occurred through material misstatements and omissions including as to diversification of investments, funds set aside to pay insurance premiums, the true relationship between JTCM/Jarkesy and JTF/Belesis, and valuation of Fund assets." Order, at p.2.

In the RIA Petition, plaintiffs brought claims of (1) breach of fiduciary duty, (2) waste, (3) negligence, (4) breach of contract, and specifically sought restitution and disgorgement of all monies paid on behalf of investors. *See* RIA Petition, at pps. 64-70. The Related Investor Action claims allege the same underlying conduct at issue in this proceeding, the exact same set of operative facts and the same theories of fraud. The following is a list of facts asserted and claims made in the RIA Petition as they relate to the underlying conduct for which disgorgement and penalties were awarded in this action:

1. **RIA Petition Alleged Facts and Claims Related to Material Misstatements and Omissions as to Diversification of Investments and funds set aside to pay insurance premiums.**

- "Jarkesy and JTCM breached their agreement with the limited partners by ignoring the investment guidelines that governed the funds." RIA Petition at ¶ 29.

- Jarkesy's and JTCM's misrepresentations included incorrect valuation of the Funds' equity positions in certain companies, incorrect valuations of the Funds' short-term notes provided to other companies, and overstating the value of at least two of the Funds' life settlement policies." *Id.* at ¶ 47.

- "None of the promissory notes issued after November 2010 was secured, violating Defendants Jarkesy and JTCM representations that the bridge loans would be 'collateralized.'" *Id.* at ¶ 67.

- The Funds raised more than $24 million in aggregate capital contributions, and thus would have been required to commit $12 million toward life settlement policies had they abided by Jarkesy's representations and statements in marketing materials he drafted. Had Jarkesy set aside the approximately $8.135 million that they represented

they represented they would, there would have been sufficient funds to pay the premiums for all of the policies purchased.... The money was not set aside to pay premiums..." *Id.* at ¶ 110.

- "[T]here were long periods of time in 2008 when Jarkesy and JTCM failed to acquire and maintain policies with a total face value of 117% of the investors' capital contributions in the Funds." *Id.* at ¶ 111.

- "[I]n 2009, Jarkesy and JTCM fell short of the insurance coverage they promised investors." *Id.* at ¶ 112.

- "Because Jarkesy and JTCM did not purchase any additional policies after May 2009 but continued to raise capital through at least 2010, the Funds were not in compliance with the 117% requirement at any time from December 31, 2009 forward." *Id.* at ¶ 113.

- "Respondents continued to falsely represent that they had 117% face value." *Id.* at ¶ 114 (citation omitted).

2. RIA Petition Alleged Facts and Claims Related to Material Misstatements and Omissions as to the true relationship between JTCM/Jarkesy and JTF/Belesis.

- "Jarkesy and JTCM intentionally, willfully or with at least gross negligence, elevated the interests of JTF, Belesis and ATB Holding those of the Funds..." *Id.* at ¶ 29; *see also id.* at ¶ 34, 164-171.

- "Jarkesy and JTCM breach their fiduciary duties by: ... ii) failing to disclose to the Funds' limited partners JTCM's and Jarkesy's repeated favoring of the pecuniary interests of Belesis, ATB Holding and JTF." *See Id.* at ¶ 30; *see also* ¶¶ 138-153.

- "While they shared the same brand name, JTCM (the advisor) purported to be wholly independent of JTF (the placement agent).... JTCM's purported indepednance from JTF was a sham designed to enrich Belesis at the expense of the Funds, and to insulate him from future accusations of wrongdoing." *Id.* at ¶¶ 31, 32.

- "Jarkesy and JTCM abandoned their fiduciary duty to the Funds by negotiating arrangements whereby borrowing companies would divert large fees to JTF and Belesis using proceeds received from the Funds." *Id.* at ¶ 33.

- "JTCM – acting through Jarkesy, its manager – represented that it was solely responsible for managing the funds.... In reality, Belesis frequently sought to intervene in the Funds' business decisions. In fact, the Fund copied Belesis as well as JTF's Chief Compliance Officer Castellano and other JTF employees on certain monthly account statements to investors." *Id.* at ¶¶ 127, 130; *see also* ¶¶ 128-129, 131-137.

3. RIA Petition Alleged Facts and Claims Related to Material Misstatements and Omissions as to the valuation of Fund assets.

- "Jarkesy and JTCM breach their fiduciary duties by: i) recording arbitrary valuations without any reasonable basis for certain of the Funds' largest holdings, thus causing the Funds' performance figures to be materially overstated and materially false and misleading; ... and iii) misrepresenting the value of the limited partners' respective capital accounts, and thereby artificially inflating JTCM's and Jarkesy's management fees and expenses." *Id.* at ¶ 30.

- "The Annual Financial Statements JTCM provided to investors ... stated that JTCM "records its investments at fair value" and adopted Financial Accounting Standard 157 for purposes of valuation of the Funds' holdings, although JTCM has no records of its pricing analysis to support its valuation." *Id.* at ¶ 36.

- "At the end of 2011, Jarkesy valued Fund I at approximately $18 million to $20 million and Fund II at approximately $10 million.... According to Jarkesy's testimony in the SEC Action, the Funds' limited partner interests today are almost worthless." *Id.* at ¶ 39 (citation and note omitted).

- "Jarkesy and JTCM wrongfully inflated the value of the Funds' assets under management." *Id.* at ¶ 45.

- "Jarkesy and JTCM misrepresented the value of limited partners' investments in the Funds..." *Id.* at ¶ 47.

- "Defendants Jarkesy and JTCM arbitrarily and inconsistently valued the shares [of Galaxy Media and Marketing Corp.] without any reasonable basis." *Id.* at ¶ 62; *see also id.*, at ¶¶ 63-68, 70.

- "Jarkesy should not have taken advantage of the higher price [of the America West stock] at the end of the year because he knew it to be a temporary boost that he orchestrated by loaning money from the Funds to America West to finance a stock promotion campaign." *Id.* at ¶ 93; *see also id.*, at ¶¶ 94-105.

The conduct underlying the disgorgement award in the instant action is the same alleged conduct underlying the claims in the Related Investor Action. The RIA Petition complains of the misstatements and omissions forming the basis of the disgorgement award.

C. The Settlement Amount in the Related Investor Action Is Attributable to the Same Conduct Underlying the Disgorgement Order in this Matter.

As noted above, the conduct complained of in the Related Investor Action Petition is the same conduct for which the disgorgement award was granted. While the precise state causes of action pursued by the investors are not identical those brought by

the Commission (*i.e.* the related investor action claims of breach of fiduciary duty, waste, negligence, and breach of contract vs. the Commission claims for violations of specific securities laws), the underlying conduct and the substantive fraud allegations forming the crux of the claims in both instances is the same. Based on those substantively-identical claims, the aggrieved investors—all of them—sought the remedy of disgorgement. *See* IRA Petition at 70 (plaintiffs sought "disgorgement of all profits, benefits, and other compensation" of Respondents).

Where the underlying conduct forming the basis of the claims is the same, offset for settlement in the Related Investor Action is necessary. *See SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996); *In re. Mutual Funds Inv. Litig.*, 681 F. Supp. 2d 622, 626 (D. Md. 2010) (offset against disgorgement award proper for amounts paid in private suits where private suits were based on substantially same facts); *SEC v. Penn Cent. Co.*, 425 F. Supp. 593, 599 (E.D. Penn. 1976) (noting that any settlement payment in a related investor action properly "serve[s] to offset part or all of a judgment for disgorgement"); *see also In re. Timbervest, LLC*, SEC Release No. 4492, 2016 WL 4426915, at *2 (Aug. 22, 2016) (offset to disgorgement for private settlement applicable where "suit was premised on the same underlying 'misconduct [that] ... was recently the subject of [respondents'] administrative enforcement action before the United States Securities and Exchange Commission').

First Jersey mirrors the facts set forth here. The SEC brought claims (in federal district court as opposed to an administrative proceeding) against the defendants for various violations of securities laws. *See id.*, 101 F.3d at 1456-61. The district court found in favor of the SEC and awarded disgorgement of $27 million. *Id.* Defendants

brought to the district court's attention the $5 million settlement in the related investor class action suit and the district court reduced the disgorgement amount by the amount of the settlement. *Id.* This reduction was upheld on appeal, the Second Circuit holding that offset in the total amount of the settlement was required because the settlement reimbursed the plaintiffs for the same conduct in the SEC action. *See Id.*; *SEC v. Penn Cent. Co.*, 425 F. Supp. 593, 599 (E.D. Penn. 1976) (disgorgement award should be offset for any restitution previously paid by settlement or otherwise); *see also Timbervest, LLC*, 2016 WL 4426915, at *2 (settlement offset appropriate where the private suit is based on the same "misconduct" as administrative enforcement proceeding).

However, any payment back to investors, regardless of the nature of the payment, would reduce the amount by which the party was unjustly enriched.

D. Settlement Payments in the Related Investor Action Have Been Made.

Plaintiffs' counsel in the Related Investor Action have confirmed that Respondents paid the full settlement amount. A copy of the email confirmation is attached as Exhibit 1. *See e.g., In re. Timbervest*, LLC, 2016 WL 4426915, at *2 (Letter from Plaintiff in related investor action sufficient to demonstrate settlement for purposes of offset).[2]

Conclusion

Based upon the arguments and authorities above, the disgorgement award in the Initial Decision should be vacated or, in the alternative, credit should be given for the amount Respondents paid toward the settlement.

[2] Respondents continue to assert that the Initial Decision improperly failed to give credit for legitimate business expenses, such as legal fees and accounting costs, and improperly failed to give credit for the personal loss of $600,000 of untainted funds invested by Mr. Jarkesy into the venture.

Respectfully Submitted,

By: _____

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Counsel for John Thomas Capital Management Group d/b/a Patriot28 LLC and George Jarkesy, Jr.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on April 13, 2018, the foregoing document was served on the parties below and in the manner indicated.

By: _____
Karen Cook, Esq.

Brent Murphy, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E., Mail Stop 3628
Washington, DC 20549
VIA FACSIMILE: 202.772.9324
VIA FEDERAL EXPRESS

The Honorable Carol Fox Foelak
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Subject: FW: Paul Rodney v. JTCMG, LLC Cause # 201354408
Date: Friday, April 13, 2018 at 12:34:11 PM Central Daylight Time
From: Jeff Campisi <jcampisi@kaplanfox.com>
To: Karen Cook <karen@karencooklaw.com>

Karen, Mr. Jarkesy paid the $500,000 settlement. I would think your client has records of the wire transfers to the settlement fund that he could submit.

Jeff Campisi
Kaplan Fox

From: Michael K. Hurst [mailto:MHurst@lynnllp.com]
Sent: Thursday, April 12, 2018 3:44 PM
To: Jeff Campisi <jcampisi@kaplanfox.com>
Cc: Jonathan R. Childers <JChilders@lynnllp.com>
Subject: Fwd: Paul Rodney v. JTCMG, LLC Cause # 201354408

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Begin forwarded message:

> **From:** Karen Cook <karen@karencooklaw.com>
> **Date:** April 12, 2018 at 2:35:26 PM CDT
> **To:** "mhurst@lynnllp.com" <mhurst@lynnllp.com>, "jchilders@lynnllp.com"

<jchilders@lynnllp.com>
Cc: "S. Michael McColloch" <smm@mccolloch-law.com>
Subject: Paul Rodney v. JTCMG, LLC Cause # 201354408

Good afternoon, Gentlemen:

I represent defendants George Jarkesy and JTCM in an SEC enforcement action against them. The administrative law judge in that case has asked for some information related to the above-referenced lawsuit. I have reached out to Andrew Edison, who represented Mr. Jarkesy and JTCM, but he has since been appointed a US Magistrate Judge in the Southern District and does not have access to the case records any longer.

I would appreciate your confirming (by email is fine) that Mr. Jarkesy and JTCM paid the $500,000 that was their portion of the settlement of the plaintiff's claims.

Please do not hesitate to contact me on my cell phone if you wish to discuss this matter. Thank you.

Regards,

Karen Cook

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April 13, 2018

Brent J. Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Mail Stop 3628
Washington, DC 20549

Via Facsimile 202.772.9324
and Federal Express

Re: In the Matter of John Thomas Capital Management, Group, LLC et al., Admin. Proc. File No. 3-15255

Dear Mr. Fields:

Enclosed please find the original and three copies of Respondents' Response To Administrative Proceedings Order Dated March 14, 2018 in the above referenced case.

If you have any questions, please do not hesitate to contact me.

Regards,

Karen Cook

Enclosures as stated

cc: The Honorable Carol Fox Foelak, via Email and U.S. Mail w/copy of Enclosure
Todd D. Brody, via Email and U.S. Mail w/copy of Enclosure
Alix Biel, via Email and U.S. Mail w/copy of Enclosure

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FAX

Date: April 13, 2018

To: Brent J. Fields, Secretary Fax: 202.772.9324

From: Karen L. Cook Pages: 16 including cover

Re: In the Matter of John Thomas Capital Management, Group, LLC et al., Admin. Proc. File No. 3-15255

Comments: Following is Respondents' Response To Administrative Proceedings Order Dated March 14, 2018 in the above referenced case.

TRANSMISSION VERIFICATION REPORT

TIME : 04/13/2018 03:23PM
NAME :
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SER.# : U63090K4N893694

DATE,TIME	04/13 03:21PM
FAX NO./NAME	*4249218712027729324
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MODE	STANDARD ECM