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ADMINISTRATIVE PROCEEDING
FILE NO. 3-15271

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of TOBY G. SCAMMELL

OPENING BRIEF IN SUPPORT OF TOBY G. SCAMMELL'S APPEAL OF INITIAL DECISION BY A HEARING OFFICER

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

RULES

Toby G. Scammell hereby appeals an initial decision made by a hearing officer, Initial Decision Release No. 516 (Nov. 7, 2013) (the "Decision"). The Decision is wrong on multiple grounds, and should be reversed. Because Toby worked for a "family office" at the time of the alleged misconduct, the Commission lacks jurisdiction. And, even if the Commission has jurisdiction (it does not), a lifetime collateral bar is not supported by a preponderance of the evidence.

I. INTRODUCTION

The Securities and Exchange Commission (the "Commission") instituted proceedings against Toby on April 10, 2013, pursuant to Section 203(f) of the Investment Advisers Act of 1940 (the "Act"). The action was premised on a judgment permanently enjoining Toby from violating Rule 10b-5. Toby consented to the entry of that judgment to settle the civil insider trading case brought against him by the Division of Enforcement (the "Division"). That case alleged that Toby misappropriated from his then-girlfriend, and traded on, information that Disney was going to acquire Marvel.[1] The case was circumstantial, weak, and based on a highly questionable legal theory that a boyfriend owes a girlfriend a fiduciary duty even where there is no proof that they have a history of sharing confidential business information with each other. Toby nevertheless settled the civil case, but he did not admit liability.[2] As part of that settlement, he also agreed that for purposes of certain related proceedings, including these administrative proceedings, he would not deny the civil complaint's allegations.[3] Nothing in that agreement, however, precludes him from arguing that the weak and circumstantial nature of the evidence weighs against an administrative sanction.

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[1] Div. Ex. 1.
[2] Div. Ex. 2.
[3] *Id.*

The hearing officer granted both parties leave to file cross-motions for summary disposition. The parties filed timely motions, oppositions, and replies, and submitted numerous exhibits.[4] In his pleadings, Toby argued that at the time of the alleged misconduct, he worked for a "family office," so the Commission could not base jurisdiction on his employment by an "investment adviser." He also argued that the allegations, even taken as true, were supported by such weak evidence that the Division could not show that a lifetime collateral bar was justified by a preponderance of the evidence. On November 7, 2013, the hearing officer issued an initial decision imposing a lifetime collateral bar against Toby. That Decision is wrong on several points and should be reversed.

Contrary to both Congressional intent and the Commission's own policy and practices, the Decision improperly concludes that prior to 2011, the Act applied to family offices that structured themselves to satisfy the private adviser exemption.[5] The Commission has never before exercised jurisdiction over a family office, regardless of the nature of its exemption. That is because the Commission concluded long ago that family offices, even though they meet the literal definition of "investment adviser," are not within the *intent* of that definition.

The hearing officer also failed to admit any of Toby's evidence, even though there was no objection to it,[6] and imposed the maximum sanction available – a lifetime collateral bar – without considering whether that sanction is supported by a preponderance of the evidence.[7] The Decision reads as if maximum sanctions are automatic following consent to an antifraud

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[4] Decision at 1; *see also* Exs. 1-43 and declarations included in Appellant's Appendix ("AA"). Citations to "Ex." are consistent with the original Exhibit numbers filed with Mr. Scammell's briefs, and correspond with Appendix citations (*i.e.*, Ex. 1 corresponds with AA 1).

[5] Decision at 3-4.

[6] *Id.* at 2-3.

[7] *Id.* at 6.

injunction. But that cannot be right because, if it is, any hearing on the matter is futile. And, in fact, applying the preponderance of evidence standard to this case, a lifetime collateral bar is *not* warranted. The Decision also appears to conclude, without support, that it is improper as a matter of law to consider the nature of Toby's employment at the time of the alleged misconduct in determining whether a sanction is in the public interest. Yet courts regularly consider such details and, here, Toby's employment weighs against imposition of a lifetime collateral bar. On December 18, 2013, the Commission granted Toby's Petition for Review. Accordingly, Toby respectfully requests that the Commission reverse the Decision.

II. FACTUAL BACKGROUND

Toby Scammell was fascinated with the stock market from an early age. He had his first trading account at age fifteen;[8] he began developing an investment theory based on the "ripple effects" events have on the stock market at age sixteen;[9] he made his first small but aggressive trades based on this theory at age eighteen;[10] and he published a monograph on his "event-based" trading theory at age nineteen.[11]

Recognizing Toby's financial acumen and interest, his brother (who is a federal law enforcement special agent), entrusted Toby with the management of the brother's financial affairs back in 2006.[12] As a result, Toby controlled his brother's money and the accounts in which Toby kept that money.[13] It was no secret Toby controlled the brother's accounts: they

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[8] Ex. 3, Appx. G at 41.
[9] Ex. 3 at 20; Ex. 14 at 122:20-124:1.
[10] Ex. 14 at 109:20-110:18; Ex. 3, Appx. F.
[11] Ex. 14 at 122:24-124:8.
[12] Ex. 16 at 73:21-24; Div. Ex. 1 ¶ 5. Toby had complete unrestricted authority over his brother's finances. Ex. 16 at 31:24-32:2, 42:17-43:9, 120:21-121:17.
[13] Ex. 16 at 68:2-69:1, 121:1-17.

were linked to Toby's accounts at Ameritrade under the same unified login.[14] None of this was disputed.

Toby got a great job when he graduated from University of Southern California in 2006.[15] He was hired by Bain Consulting in Los Angeles.[16] Bain had a strict anti-insider trading policy to which Toby scrupulously adhered, so for the two years he was at Bain, he did almost no stock trading.[17] One exception was in 2008, when he invested $5,300 in Google by buying high-risk, out-of-the-money Google call options.[18] He held onto those options too long, however, and lost the paper profits he had made and his initial investment.[19] Again, this prior options trading was not disputed.

While at Bain, Toby worked on a number of projects. One involved research into how movie studios, such as Disney, might respond to the rapid decline in movies sold as DVDs. Toby concluded, unsurprisingly, that the content (*i.e.*, what the movie was about) mattered, and that movies based on comic book superheroes were likely to hold their value longer and generate better returns for the studios. Toby's research made him believe that a comic book company, of which Marvel was one of a few, might be coveted as an acquisition target by Disney, and other studios.[20] This was also undisputed.

While at Bain, Toby also participated in a discussion about Marvel: one of the Bain

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[14] Ex. 3 at 30.
[15] Ex. 12 at 19:21-24.
[16] *Id.* at 37:5-7.
[17] *Id.* at 89:21-90:24, 164:2-165:11.
[18] Ex. 3 at 21-26, Appx. F at 44; Ex. 14 at 117:17-118:23; *see also* Div. Ex. 1 ¶ 35 (noting that Toby previously traded Google call options).
[19] Ex. 3 at 25, Appx. F; Div. Ex. 1 ¶ 35.
[20] Ex. 12 at 99:14-137:15; *see also* Div. Ex. 1 ¶ 54 (noting Toby's belief that Marvel's comic content was undervalued, that DVD sales would ultimately decline, and that consumers were more likely to purchase Marvel DVDs than others).

employees knowledgeable about the movie industry said words to the effect that Disney had been trying to acquire Marvel for years.[21] Immediately following that meeting, Toby researched Marvel on Google.[22] There was no proof to the contrary.

Toward the end of his tenure at Bain, Toby traveled to Africa. He left on June 22, 2009;[23] returned briefly to Los Angeles on July 9;[24] had his last day at Bain on July 31;[25] moved to Northern California that weekend;[26] and began work at his dream job at Madrone, the investment office for the Walton family, on August 3.[27] Those dates are not in dispute.

While at Bain, Toby had met, and begun dating, a co-worker in Bain's Los Angeles office.[28] They were not engaged; and they both had ambitions that likely excluded the other: she to go to business school and he to work in Silicon Valley for Madrone.[29] The girlfriend lived in Los Angeles and continued to live in Southern California after Toby moved 350 miles north to the San Francisco Bay Area to work for Madrone.[30] Toby and his girlfriend never "lived together" as the term is usually understood; he did, however, camp at her apartment from mid-July after his lease had expired until he left Los Angeles at the end of July.[31] These facts were also not disputed.

Before Toby went to Africa, the girlfriend had been seconded by Bain to work at Disney.

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[21] Ex. 12 at 137:11-20.
[22] Ex. 3, Appx. B; Ex. 15 at 175:6-16.
[23] Ex. 3, Appx. G at 5; Ex. 12 at 91:18-20; *see* Div. Ex. 1 ¶ 23.
[24] Ex. 3, Appx. G at 5; Ex. 12 at 91:18-20; *see* Div. Ex. 1 ¶ 24.
[25] Ex. 12 at 37:5-7; *see* Div. Ex. 1 ¶ 27 (noting that Toby moved to San Francisco on or about August 2).
[26] Ex. 12 at 210:1-10; *see* Div. Ex. 1 ¶ 27.
[27] Ex. 12 at 91:18-24; *see* Div. Ex. 1 ¶ 27.
[28] Ex. 12 at 317:12-1; Div. Ex. 1 ¶ 20.
[29] Ex. 12 at 212:14-21, 215:9-15, 37:5-9 (testifying that his girlfriend had applied to business schools around the country); Div. Ex. 1 ¶ 28.
[30] Ex. 12 at 89:4-7, 210:2-24; Div. Ex. 1 ¶ 27.
[31] Ex. 12 at 210:2-24; Div. Ex. 1 ¶ 10.

She worked in the Disney group that did acquisitions. She eventually was staffed on the "big project" in late July.[32] Even before she was staffed on that "big project," however, Toby continued researching Marvel. This is also undisputed, as is the fact that his Google search records show that he researched Marvel on July 22 and 23, which was before the girlfriend was assigned to the "big project."[33] The "big project" turned out to be the acquisition of Marvel.[34] The girlfriend was not assigned to it, and she had not received any documents about it, until July 24.[35]

Before moving to the Bay Area, Toby saw that his girlfriend was working long hours;[36] he knew she was working on a big project;[37] and he knew she was in the group that did acquisitions.[38] It was not hard to infer that she was working on an acquisition.

Armed with the beliefs that (1) Disney was working on an acquisition, (2) Marvel would be a logical candidate for Disney to acquire, and (3) Disney had previously been interested in acquiring Marvel, Toby continued to research Marvel. He believed that regardless of whether Marvel was actually the target of a Disney acquisition, Marvel's stock price would benefit if another company in the same space were to be acquired.[39] This, too, was undisputed.

Freed from the restraints of Bain's strict insider trading policy, Toby was anxious to

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[32] Ex. 12 at 81:5-83:1; Div. Ex. 1 ¶ 25.

[33] Ex. 3, Appx. B.

[34] Div. Ex. 1 ¶ 25.

[35] *Id.*; Ex. 18 at 28:11-29:10; Ex. 5 (Disney production identifying the earliest date by which Toby's girlfriend received Marvel-related documents. The cover email mistakenly describes the attached documents as being from June 24, 2009, but the documents are all dated July 24, 2009).

[36] Div. Ex. 1 ¶ 26.

[37] *Id.* ¶ 25.

[38] *Id.* ¶ 28.

[39] Ex. 13 at 28:19-29:4; *see also* Div. Ex. 1 ¶ 57 (noting Toby's claim that even a small increase in the Marvel stock price would result in a significant increase in the price of Marvel options he purchased).

invest again.[40] After checking on Madrone's trading policy, Toby determined he could invest in Marvel without violating his employer's rules.[41] There were few Marvel options to choose from, but of those available, Toby purchased options with the strike price and expiration date he could afford.[42] Consistent with prior (and subsequent) practice, Toby made a very small, but highly leveraged, investment.[43] At the time he invested, he had received a vacation payout, expense reimbursements, and a final bonus from Bain and was starting a job at Madrone where his salary was more than $3,000 every two weeks.[44] He invested only $5,465 to buy short-term out-of-the-money options in Marvel.[45] A small movement in Marvel's stock price would cause a relatively large movement in the option price.[46] So if Disney made an acquisition that had a positive ripple effect on Marvel's stock price (or the stock price rose for any other reason), he expected to make money. If that did not happen, and Marvel's stock price failed to rise, he could lose no more than $5,465.[47] He bought the options between August 13 and August 28 in the account he

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[40] Ex. 12 at 226:4-12.

[41] Ex. 14 at 133:22-134:12.

[42] Ex. 15 at 32:6-33:13.

[43] Div. Ex. 1 ¶ 2.

[44] Ex. 13 at 260:7-261:2.

[45] Div. Ex. 1 ¶ 2. Options are riskier, but less expensive than other investment strategies. *See* Ex. 6 ("Options Trading allows investors with very small funds to gain disproportionately big profits and to control stocks that would otherwise be too expensive to own."); *see also* Ex. 7 (buying call options "offers the protection of limited downside loss with the benefit of leveraged gains.").

[46] *See* Ex. 13 at 147:19-158:1 (demonstrating and describing the concept of leverage); Ex. 6 ("Leverage in layman terms simply means making a lot of money using only very little money. Indeed, when you buy call options, you could make 100% profit when the stock has moved only 10% due to the small upfront money you paid for the call options!"); Div. Ex. 1 ¶ 57 (noting Toby's claim that even a small increase in the Marvel stock price would result in a significant increase in the price of Marvel options he purchased).

[47] Div. Ex. 1 ¶ 2.

controlled for his brother and an account in his own name.[48]

On August 31, Disney announced it was acquiring Marvel.[49] Over the next few days, Toby sold the Marvel options for a total profit of $192,497.[50]

As part of the Commission's investigation into the trades, Toby provided four days of testimony and his former girlfriend provided two. The staff also reviewed all of their communications, spoke with their co-workers and friends, and examined countless documents. The Commission failed to identify a single document, conversation, or email that contained the allegedly misappropriated confidential information. Conceding that there is no proof of when or how Toby purportedly learned the information, the Complaint resorts to alleging only that Toby must have learned the name of the acquisition target "through overhearing one or more of his girlfriend's Marvel-related conversations, by seeing electronic or paper documents in her possession related to the Marvel acquisition, or through her conversations with him."[51]

Toby consented to a judgment against him even though the Commission's case was entirely circumstantial, and every suspicious circumstance had an explanation. In consenting to judgment, Toby agreed to pay disgorgement, civil penalties, and prejudgment interest.[52] While he does not deny the allegations in the Complaint, he does not admit them. He does, however, recognize now that in purchasing the Marvel call options under such suspicious circumstances, he invited the Commission's inquiry, and he exposed his loved ones to suspicion, damaged

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[48] *Id.* ¶ 31. Toby testified that in the event he lost any of his brother's money, he was prepared to backstop those losses and that by the end of August he had already repaid some of that money thinking he had lost it. Ex. 3 at 31; Ex. 12 at 265:12-20, 279:19-282:1.

[49] Div. Ex. 1 ¶ 6.

[50] *Id.* ¶ 7.

[51] *Id.* ¶ 30.

[52] Ex. 8.

reputations, and the inconvenience and expense of an SEC enforcement investigation.[53] He regrets the lapse in judgment that allowed him to make options trades that would, in hindsight, obviously appear to be based on improperly obtained information regardless of whether they actually were.[54]

He also regrets the action he took in reaction to hearing that the SEC would be suing him. He posted a website ("Secfail.com") that criticized the SEC and included *ad hominem* attacks on staff. Toby regrets that he did so: he now appreciates the role the Commission plays in enforcing the securities laws and protecting the capital markets and recognizes that the staff's zeal is important to that effort.[55]

The staff's investigation and lawsuit have already had severe consequences for Toby. They cost him his job at Madrone;[56] they cost him large legal fees[57] and they are going to cost him disgorgement and penalties in an amount to be determined. He was also recently indicted for the same alleged conduct for which the Division sued him, and intends to vigorously defend himself against those allegations. The mistakes Toby made when he was twenty-four are going to have life-long repercussions. Compounding those repercussions with a bar – especially a lifetime collateral bar – would serve no legitimate interest.

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[53] AA 45 ¶ 7.
[54] *Id.*
[55] *Id.* ¶ 9.
[56] *Id.* ¶ 11.
[57] *Id.*; *see also* Ex. 12 at 313:14-314:4.

rules and regulations or orders."[64] The Commission has used both rules and regulations to designate family offices as "not within the intent" of the definition: before 2011, it routinely granted orders exempting family offices with the characteristics of Madrone[65] and, in 2011, it codified that policy by rule.[66]

Even though family offices have historically been allowed to seek orders exempting them from all of the Act's provisions,[67] most, including Madrone, did not bother because they were already excluded from the Act under an exemption for investment advisers with fewer than

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[64] 15 U.S.C. § 80b-2(a)(11)(G) (Sept. 29, 2006) (emphasis added). After the Dodd-Frank amendment, that language was moved to subparagraph (H) and the new subparagraph (G) explicitly addressed family offices. *See* 15 U.S.C. §§ 80b-2(a)(11)(G) & (H) (July 21, 2010).

[65] *Compare* Div. Ex. 4 *with* SEC orders exempting family offices (*In re WLD Enters., Inc.*, Rel. No. 2807, 2008 WL 5600304 (S.E.C. Nov. 14, 2008); *In re Woodcock Fin. Mgmt. Co.*, Rel. No. 2787, 2008 WL 5084855 (S.E.C. Sept. 24, 2008); *In re Slick Enters. Inc.*, Rel. No. 2745, 2008 WL 4240010 (S.E.C. June 20, 2008); *In re Gates Capital Partners, LLC*, Rel. No. 2599, 2007 WL 1001551 (S.E.C. Mar. 20, 2007); *In re Adler Mgmt., LLC*, Rel. No. 2508, 2006 WL 1028874 (S.E.C. April 14, 2006); *In re Riverton Mgmt., Inc.*, Rel. No. 2471, 2006 WL 119133 (S.E.C. Jan. 6, 2006); *In re Parkland Mgmt. Co.*, Rel. No. 2369, 2005 WL 1498457 (S.E.C. Mar. 22, 2005); *In re Longview Mgmt. Grp. LLC*, Rel. No. 2013, 2002 WL 192323 (S.E.C. Feb. 7, 2002); *In re Kamilche Co.*, Rel. No. 1970, 2001 WL 1739962 (S.E.C. Aug. 27, 2001); *In re Bear Creek, Inc.*, Rel. No. 1935, 2001 WL 327593 (S.E.C. April 4, 2001); *In re Moreland Mgmt. Co.*, Rel. No. 1705, 1998 WL 102669 (S.E.C. Mar. 10, 1998); *In re Pitcairn Co.*, Rel. No. 52, 1949 WL 35503 (S.E.C. Mar. 2, 1949); *In re Roosevelt & Son*, Rel. No. 54, 1949 WL 35524 (S.E.C. Aug. 31, 1949); *In re Donner Estates, Inc.*, Rel No. 21, 1941 WL 37931 (S.E.C. Oct. 30, 1941)). *See also* 17 C.F.R. § 275.202(a)(11)(G)-1(b) (defining family offices in a manner consistent with the Commission's prior exemptive orders).

[66] 17 C.F.R. § 275.202(a)(11)(G)-1(b).

[67] 75 Fed. Reg. 63753-01, 63754; *see also* S. REP. NO. 111-176, at 75 (2010) (Conf. Report) (Ex. 19) ("Since the enactment of the Investment Advisers Act of 1940, the SEC has issued orders to family offices declaring that those family offices are not investment advisers within the intent of the Act . . . The Committee believes that family offices are not investment advisers intended to be regulated under the Advisers Act."); *see also* H.R. 2225 (noting that "Family offices are not of national concern" and that "since the Investment Advisers Act of 1940 was enacted, the Securities and Exchange Commission has regularly issued orders to individual family offices exempting them from all provisions of the Investment Advisers Act of 1940").

fifteen clients.[68] But the fact that they did not seek an exemption order does not change the fact that they were family offices.[69] Such orders did not create family offices; they merely "reflected" the Commission's broader policy that family offices were never within the intended scope of the Act.[70]

Nor is the hearing officer's suggestion correct that in order to be a family office, Madrone would have needed to "'"rely" on exemptive orders issued to other persons.'"[71] It is beyond dispute that at the time of Toby's Marvel trades, Madrone was a family office.[72] The Decision does not cite a single example in which this Court has exercised jurisdiction based on association with a family office, and ignores the fact that the typical single family office has been recognized by the Commission and Congress as *different* from other entities that qualified for the private

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[68] *See, e.g.*, Div. Ex. 4 ¶ 6 (testifying that Madrone "never sought or obtained from the Commission an exemptive order under Section 202(a)(11)(G) of the Investment Advisers Act declaring those entities not to be investment advisers as, it is my understanding, both entities were already exempt from registration under Section 203(b)"); *see also* 75 Fed. Reg. 63753-01, 63754 (noting that there are approximately 2,500 to 3,000 single family offices managing more than $1.2 trillion in assets, many of which were structured to take advantage of the private adviser exemption, and that the Commission has issued about a dozen exemptive orders since the 1940s); *see also* a chronological list of notices and orders of applications filed under the Advisers Act since January 1, 2006, *available at* http://www.sec.gov/rules/iareleases.shtml#chron.

[69] 75 Fed. Reg. 63753-01, 63754 ("many family offices" relied on the private adviser exemption).

[70] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), P.L. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S. Code) § 409(b) ("instructing that the family office rule must be "consistent with the previous exemptive policy of the Commission, *as reflected in* exemptive orders for family offices") (emphasis added).

[71] Decision at 4 n.3 (citation omitted).

[72] Madrone had no clients other than family clients, was wholly owned by family clients, exclusively controlled (directly or indirectly) by one or more family members and/or family entities, and did not hold itself out to the public as an investment adviser. *See* Div. Ex. 4 ¶¶ 12, 13, 18, 19. *Compare* SEC orders exempting family offices listed *supra* n.65.

adviser exemption.[73] That difference meant that at any time, Madrone could have sought and obtained an exemptive order excluding it from all provisions of the Act. Like most family offices, Madrone never obtained such an order because it did not have to.[74]

Congress never intended for family offices to be regulated under the Act,[75] a fact the Commission has always recognized and respected.[76] Ignoring that history to impose a bar in this case would be unprecedented and unwarranted.

B. Toby Is Not Seeking Retroactive Application of the Family Office Rule

The relevant question in determining whether the Act applies here is whether *at the time of Toby's Marvel trades* the Commission intended that family offices like Madrone be excluded from the Act. It did. The Commission (and Congress) intended family offices like Madrone to be excluded entirely from regulation under the Act and manifested that intent in the orders it regularly issued "exempting them from all of the provisions of the Investment Advisers Act of

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[73] 76 Fed. Reg. 37983-01, 37983-84 (June 29, 2011) (codified at 17 C.F.R. pt. 275.202(a)(11)(G)-1)) ("Historically, family offices that fell outside the private adviser exemption have sought and obtained from us orders under the Advisers Act declaring those offices not to be investment advisers within the intent of" the Act, and that those orders reflected the Commission's view that the typical single family office is "not the sort of arrangement that the Advisers Act was designed to regulate.") (referencing 75 Fed. Reg. 63753-01, 63754). Nor does it matter that the Commission expressed concern that some "advisers" that failed to qualify for the private adviser exemption had also failed to apply for an exemptive order. *See* Division Opp. at 15-16. As already explained, *supra*, exemptive orders are not what made a family office a family office. Exemptive orders reflected the Commission's policy as it existed at the time – that the typical family office was not an "investment adviser" for purposes of the Act. Even if not all "advisers" would have qualified for an order, Madrone would have.

[74] AA 46 ¶ 6 (Madrone never obtained an order "as, it is my understanding, both entities were already exempt from registration under Section 203(b)").

[75] *See* H.R. 2225 ("Family offices are not of national concern in that their advice, counsel, publications, writings, analyses, and reports are not furnished or distributed to clients on a retail basis, but are instead furnished or distributed only to persons who are members of a particular family").

[76] 75 Fed. Reg. 63753-01, 63754 (the Commission has regularly exempted family offices from the Act because they are "not the sort of arrangement that Congress designed the Advisers Act to regulate").

1940."[77]

The Decision reasons, incorrectly, that Toby's argument that Madrone was a family office in 2009 depends on retroactive application of a 2011 Rule that codified the Commission's long-held policy that family offices like Madrone were beyond the scope of the Act.[78] It is not. The 2011 Rule is a convenient tool that the Commission may use to help interpret its own prior orders, but to determine that Madrone was a family office in 2009, it is not necessary to apply the Rule at all, let alone retroactively.

Subsequent to Toby's trades, the Advisers Act was amended as a result of the Dodd-Frank reforms. One of the changes was to make explicit what had long been understood: the Act does not apply to family offices.[79] The amendment modified the definition of investment adviser to explicitly exclude family offices "as defined by rule, regulation, or order of the Commission."[80] The amendment was necessary to assure that family offices did not become regulated when Dodd-Frank repealed the private adviser exemption (allowing hedge funds to be regulated).[81] In directing the Commission to define "family office," Congress required not only

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[77] *Id.* (the Commission has regularly exempted family offices from the Act because they are "not the sort of arrangement that Congress designed the Advisers Act to regulate"); *see also* H.R. 2225 (since 1940, the Commission has regularly issued orders to individual family offices exempting them from all provisions of the Act).

[78] Decision at 4 (because the Rule was enacted "two years after" Toby traded in Marvel, "he cannot rely on it to argue that his employer was not an investment adviser at the time of his violation").

[79] Dodd-Frank Act § 409(b); *see also* H.R. 2225 (noting that since the Act's enactment, family offices have been regularly exempted from its provisions).

[80] 15 USC § 80b-2(a)(11)(G).

[81] *See* 76 Fed. Reg. 37983-01, 37983 ("We proposed this rule in anticipation of the Dodd-Frank Wall Street Reform and Consumer Protection Act's . . . repeal of the private adviser exemption from registration contained in section 203(b)(3) of the Advisers Act, effective July 21, 2011, upon which many family offices currently rely."); *see also* 75 Fed. Reg. 63753-01, 63754 (noting that a consequence of Dodd-Frank is that "many family offices that have relied on

that the definition be "consistent with" the Commission's historical exemptive orders, but also that it be broad enough to reflect "the range of organizational, management, and employment structures and arrangements" family offices employ.[82]

In response, the SEC adopted Rule 202(a)(11)(G)-1 (the "Rule").[83] Under the Rule, a "family office":

- Has no clients other than family clients;
- Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and
- Does not hold itself out to the public as an investment adviser.[84]

When the Rule took effect, Madrone Advisors qualified as a family office without making any changes whatsoever.[85] Therefore, at the time of the alleged violation, Toby was working for what was unquestionably a family office.

No retroactive application of the Family Office Rule is required to reach this conclusion. What is required is the application of 15 U.S.C. § 80b-2(a)(11)*(G)* (excluding persons not within the intent of the statute from the definition of "investment adviser") *as it existed at the time of the alleged conduct* and which the hearing officer ignored. The Rule was required to codify prior practice.[86] The hearing officer erred in foreclosing the use of the Family Office Rule and its

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[the private advisers] exemption would be required to register under the Advisers Act or seek an exemptive order before that section of the Dodd-Frank Act becomes effective").

[82] Dodd-Frank Act § 409(b); *see also* H.R. 2225.

[83] *See* 76 Fed. Reg. 37983-01, 37984 (noting that the Commission's definition of family office reflects "the purpose of the exclusion and the legislative instructions we received").

[84] 17 C.F.R. § 275.202(a)(11)(G)-1(b).

[85] Div. Ex. 4 ¶¶ 7-8.

[86] Dodd-Frank Act § 409(b) (instructing that the Rule be "consistent with the previous exemptive policy of the Commission"); 76 Fed. Reg. 37983-01, 37984 (noting that "section 409 of the Dodd-Frank Act instructs that any family office definition the Commission adopts should be 'consistent with the previous exemptive policy' of the Commission" and that the Rule is in fact consistent with that policy).

commentary as evidence of the Commission's intent by characterizing such use as a retroactive application. As already noted, the Rule did not create a new benefit; it protected an existing one.[87] Because the Rule was required to and does reflect the Commission's historical policies and practices, it (and the commentary around it) simply help establish that Madrone was a family office at the time of the alleged conduct.[88] Because the Advisers Act was never intended to apply to family offices, Section 203(f) cannot be a basis for barring Toby now.[89]

IV. IMPOSITION OF A LIFETIME COLLATERAL BAR IS NOT SUPPORTED BY A PREPONDERANCE OF THE EVIDENCE

Because Toby worked for a family office at the time of the alleged conduct, the Commission lacks jurisdiction and the Decision may be reversed without deciding the remaining issues on appeal. If, however, the Commission concludes that jurisdiction exists (it does not), the Decision should still be reversed because the hearing officer failed to consider whether the imposed sanction was in the public interest by a preponderance of evidence, and it is not.

A. The Evidence Toby Submitted Should Be Admitted

Along with his pleadings filed in support of his motion for summary disposition, Toby submitted forty-three exhibits and six declarations demonstrating the weak nature of the Division's evidence.[90] The Division did not object to the exhibits, yet the hearing officer failed to admit any of them.[91] Instead, the hearing officer based her decision on the docket report, the

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[87] Notably, that protection was only necessary in the first place so that Congress could increase regulation of hedge funds, which did actually pose a threat to the national interest. *See* 75 Fed. Reg. 63753-01, 63754.

[88] *See* 17 C.F.R. § 275.202(a)(11)(G)-1(b) (defining family office); *see also generally* Div. Ex. 4 (describing Madrone's structure, which at the time of the alleged misconduct met, and still meets, the Rule's definition).

[89] *See id.*

[90] Toby's evidence not admitted into the Record is attached pursuant to Rule 450(b). *See* AA 1-49.

[91] *See* Decision at 2.

court's civil orders, four exhibits submitted by the Division, and the facts alleged in the injunctive complaint.[92]

To be clear, none of the evidence or facts at issue in this case have ever been litigated, so the hearing officer's observation that "[t]he Commission does not permit a respondent to relitigate issues that were addressed in a previous civil proceeding against a respondent"[93] is inapplicable. Nor has Toby denied the allegations in the complaint. Throughout these proceedings, Toby argued only that the evidence supporting those allegations is weak, circumstantial, and – in light of additional undisputed facts – insufficient to support a bar, especially a lifetime collateral bar, the maximum sanction available.

That Toby consented to a judgment enjoining him should not prevent him from making those arguments. Indeed, it cannot, because the imposition of an administrative sanction must be found to be in the public interest by a preponderance of evidence.[94] The hearing officer's failure to admit any of Toby's exhibits into evidence was a prejudicial error.[95] Moreover, the Commission should refrain from drawing the legal conclusion that sanctions are warranted based

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[92] *Id.* at 2-3.

[93] *Id.* at 2.

[94] *See Steadman v. Securities & Exchange Commission*, 450 U.S. 91, 101-04 (1981); *see also In re John Jantzen*, Rel. No. 472, 2012 WL 5422022, at *2 (S.E.C. Nov. 6, 2012); *In re Christopher A. Seeley*, Rel. No. 508, 2013 WL 5561106, at *1 n.1 (S.E.C. Oct. 9, 2013) (admitting forty-five of forty-nine exhibits offered by the Division in a follow-on proceeding, noting that Respondent did not offer any, and applying preponderance of evidence standard).

[95] *See In re Peter Siris*, Rel. No. 3736, 2013 WL 6528874, at *8 (S.E.C. Dec. 12, 2013) (it is "well-established" that a respondent in a follow-on proceeding may introduce evidence regarding the circumstances surrounding the conduct forming the basis of the underlying proceeding in addressing whether sanctions are in the public interest, and that respondent may "put forward mitigating evidence").

solely on the factual allegations contained in the civil complaint.[96] Toby's evidence should be admitted so that the Commission may determine whether a sanction is in the public interest by a preponderance of the evidence.

B. This Court Must Weigh the Evidence Supporting the Allegations

The Commission's opinions make clear that the severity of the sanction imposed is tied directly to the strength of the evidence supporting it.[97] The applicable standard is a preponderance of the evidence.[98] Nonetheless, the hearing officer failed to consider whether a preponderance of evidence supported the sanction imposed against Toby. Instead, she imposed the maximum punishment available – a lifetime collateral bar – simply because since 1995, some form of bar has always been imposed in follow-on proceedings based on anti-fraud injunctions.[99] The hearing officer further noted, inexplicably, that "[t]he Commission's opinions do not make clear the factors that distinguished" cases that imposed less than a lifetime collateral bar from those that did not, and that "there is little difference between a 'bar' and a 'bar with the right to

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[96] *See Ashcroft v. Iqbal*, 556 U.S. 662, 663 (2009) (recognizing "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions") (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

[97] *See, e.g.*, *In re Robert Radano*, Rel. No. 2750, 2008 WL 2574440, at *1 (S.E.C. June 30, 2008); *In re Martin B. Sloate*, Rel. No. 38373, 1997 WL 126707, at *3 (S.E.C. Mar. 7, 1997); *In re Richard J. Puccio*, Rel. No. 37849, 1996 WL 603681, at *1 (S.E.C. Oct. 22, 1996); *see also Jantzen*, 2012 WL 5422022, at *2; *In re Ran H. Furman*, Rel. No. 459A, 2012 WL 2339281, at *7 (S.E.C. June 20, 2012); *see also Siris*, 2013 WL 6528874, at *8 (it is "well-established" that a respondent in a follow-on proceeding may introduce evidence regarding the circumstances surrounding the conduct forming the basis of the underlying proceeding in addressing whether sanctions are in the public interest, and that respondent may "put forward mitigating evidence").

[98] *Id.*

[99] Decision at 6 (noting that Toby pointed to "various factors" in support of his argument to dismiss, but "[h]e does not, however, cite any follow-on case in which a respondent had been enjoined against violations of the antifraud provisions and received no sanction or a sanction less than a bar. None exists. From 1995 to the present, there have been over thirty-five follow-on proceedings based on antifraud injunctions in which the Commission issued opinions. All of the respondents were barred – thirty-three unqualified bars and three bars with the right to reapply after five years." (internal citations omitted).

reapply in five years.'"[100]

In other words, the Decision concludes that the mere fact that Toby has been enjoined is sufficient to impose a lifetime collateral bar against him, a position that is untenable under the law.[101] If the Decision is right, then an antifraud injunction on its own is always enough, which means the evidence does not matter, and the hearing is, apparently, an exercise in futility.

C. A Bar is Not in the Public Interest

The imposition of a bar must be in the public interest.[102] In weighing the factors relevant to determining whether administrative action is in the public interest, the more severe the sanction imposed, the greater the Division's burden of justification.[103] The Division bears the burden of proving its contentions by a preponderance of the evidence.[104]

In determining whether an administrative sanction is in the public interest, the Commission considers six factors: (1) the egregiousness of the defendant's actions, (2) the isolated or recurrent nature of the infraction, (3) the degree of scienter involved, (4) the sincerity of the defendant's assurances against future violations, (5) the respondent's recognition of the wrongful nature of his conduct, and (6) the likelihood that the defendant's occupation will

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[100] *Id.* at 6 n.6.

[101] *See Steadman v. Securities & Exchange Commission*, 603 F.2d 1126, 1139 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (listing factors courts weigh in determining whether a sanction is in the public interest); *In re Robert Sayegh*, Rel. No. 41266, 1999 SEC LEXIS 639, at *18-19 (S.E.C. Mar. 30, 1999) (describing circumstances that warrant a collateral bar); *see also In re Gary M. Kornman*, Rel. No. 2840, 2009 WL 367635, at *9 (S.E.C. Feb. 13, 2009) (the appropriate sanction "depends on the facts and circumstances of each case").

[102] *See* 15 U.S.C. § 80b-3(f) (requiring that a proposed action under this section is "in the public interest"); Ex. 1 § III.B (asking this Court to determine, "[w]hat, if any, remedial action is appropriate in the public interest").

[103] *Steadman*, 603 F.2d at 1139.

[104] *Steadman*, 450 U.S. at 101-04; *Jantzen*, 2012 WL 5422022, at *2.

present opportunities for future violations.[105] Additionally, the Commission considers the age of the violation, the degree of harm to investors and the marketplace, and the extent to which the sanction will have a deterrent effect.[106] The inquiry is flexible and no one factor is dispositive.[107]

Throughout these proceedings, the Division has relied on innuendo and half-truths to argue for a lifetime bar, and Toby has met each unsupported attack with evidence demonstrating its misconstruction or falsity. While Toby cannot, and does not, deny the allegations in the Complaint, indisputable facts round out the reality of what happened here and demonstrate it was not so bad as to warrant a lifetime collateral bar against a twenty-eight year-old with no prior wrongdoing.

1. The Non-Egregious Nature of the Alleged Misconduct Weighs Against a Bar

The alleged violation is not sufficiently egregious to warrant a bar. Toby has not been convicted of a crime or even found liable in a civil proceeding. He consented to the entry of a judgment against him.[108] There is no allegation that any investors were harmed by Toby's trades[109] and the alleged misconduct did not involve any Madrone clients or identifiable third

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[105] *Steadman*, 603 F.2d at 1140.

[106] *In re Gary M. Kornman*, Rel. No. 335, 2007 WL 2935591, at *6 (S.E.C. Oct. 9, 2007).

[107] *In re Eric J. Brown*, Rel. No. 3376, 2012 WL 625874, at *12 (S.E.C. Feb. 27, 2012).

[108] *See, e.g.*, *Kornman*, 2007 WL 2935591, at *6 (considering egregiousness of misconduct and noting that a *conviction* involving dishonesty requires a bar); *In re Jilaine H. Bauer*, Rel. No. 483, 2013 WL 1646913, at *4 (S.E.C. Apr. 16, 2013) (seven-month suspension warranted where U.S. District Court had found that defendant willfully violated the antifraud provisions).

[109] *See, e.g.*, *In re David Mura*, Rel. No. 491, 2013 WL 2898034, at *10 (S.E.C. June 14, 2103) (noting that defendant "solicited numerous individuals to invest in what are now worthless securities, causing them to lose large portions of, in some cases, their savings and retirement funds"); *Brown*, 2012 WL 625874, at *14 (finding violations egregious in part because the defendant "repeatedly took advantage of older customers, many of whom had limited resources, and he continued to commit violations after having been sanctioned by the Florida Department of Financial Services"); *In re Lodavina Grosnickle*, Rel. No. 441, 2011 WL 7444647, at *6 (S.E.C. Nov. 10, 2011) ("dozens of victims" resulting in a fraud loss of $3.78 million).

parties.[110] Insider trading is purportedly harmful to the markets generally, but the lack of harm to identifiable third parties in this instance weighs against a finding of egregiousness.[111] The amount he invested was small, and the amount of profit was out of Toby's control, and not so significant as to warrant a bar in light of all the other circumstances.[112] The fact that Toby was not a registered investment adviser or broker at the time of the alleged violation further weighs against a bar, as does the fact that the trading had nothing whatsoever to do with Toby's employment at Madrone.[113]

In the civil case the SEC did not adduce evidence, or even allege, that the purported misappropriation of information was in any way egregious. Notwithstanding the extensive investigation, the Complaint effectively conceded that the Division had no idea how the alleged misappropriation purportedly occurred: it alleged that Toby obtained nonpublic information "through overhearing one or more of his girlfriend's Marvel-related conversations, by seeing electronic or paper documents in her possession related to the Marvel acquisition, or through her conversations with him."[114]

In short, there is no direct evidence that Toby obtained nonpublic information, no

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[110] *Jantzen*, 2012 WL 5422022, at *5-6 (rejecting permanent bar for insider trading, noting, inter alia, that respondent's misconduct did not involve any of his clients or identifiable third parties).

[111] *Id.* (rejecting permanent bar for insider trading, noting, *inter alia*, that respondent's misconduct did not involve any of his clients or identifiable third parties); *cf In re James C. Dawson*, Rel. No. 3057, 2010 WL 2886183 (S.E.C. July 23, 2010) (barring defendant from association with investment advisers where Division had alleged in the Complaint that the defendant defrauded his clients).

[112] *See, e.g., In re David E. Ruskjer*, Rel. No. 489, 2013 WL 2390731, at *4 (S.E.C. June 3, 2013) (defendant's conduct was egregious because he misappropriated at least $5.5 million from investors and fraudulently raised approximately $16 million).

[113] *See, e.g., Jantzen*, 2012 WL 5422022, at *5-6 (noting defendant was a "licensed securities broker").

[114] Div. Ex. 1 ¶ 30.

evidence whatsoever as to when or how he obtained any information, and no possible contention that the purported misappropriation was done in a way that could be described as egregious.

2. The Isolated Nature of the Alleged Infraction Weighs Against a Bar

The alleged violation was isolated in nature. Toby has no history of securities violations or other violations of any kind and there is nothing in the Complaint that suggests he has ever committed illegal acts or misled the public.[115] Toby's Marvel option purchases were a single episode made within a short period of time.[116] The fact that he made multiple purchases related to a single event does not alter the analysis, as a single incident can be composed of "several different actions all designed to achieve the same goal."[117] The Division has never suggested that any of Toby's many other trades – those made before Marvel or after – were improper, even though most of them were just as risky and speculative as the Marvel call options and even though by trading call options (other than Marvel's) Toby nearly doubled the value of his IRA in just a few months.[118] Because the alleged infraction was isolated in nature, this factor weighs against a bar.

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[115] *See Securities & Exchange Commission v. Johnson*, 595 F. Supp. 2d 40, 44 (D.D.C. 2009) (determining that a securities violation was "an isolated incident" in part because the defendant "had never previously committed such fraudulent conduct or a violation of the Exchange Act . . . and there is nothing in the record to suggest that he had ever committed illegal acts or misled the public"); *see also Jantzen*, 2012 WL 5422022, at *6 (a securities violation was isolated in nature where the Commission had not alleged any other acts of insider trading and the defendant did not have a record of any securities violations).

[116] Div. Ex. 1 ¶¶ 31, 34 (Toby purchased Marvel call options between August 13 and August 28 and sold them all within a few days of Disney's announcement that it was acquiring Marvel).

[117] *See Johnson*, 595 F. Supp. 2d at 44.

[118] *See* Ex. 3 at 26-30. After the Marvel trades and before he learned of the Commission's investigation, Toby made more than $261,000 in options purchases in short-term trades in seven different companies. Many of those trades were based on Toby's informed speculation about future events including acquisition speculation, earnings reports, and regulatory decisions. In fact, during just the three-month period between October 1 and December 31, 2009, Toby

3. The Degree of Scienter Weighs Against a Bar

In considering scienter, "[i]t is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is 'intentional or willful conduct designed to deceive or defraud investors[.]'"[119] The Commission has not alleged that Toby harmed investors or that he acted willfully, only that he acted "knowingly and/or recklessly."[120]

It is particularly difficult to ascribe scienter to Toby given the exotic legal theory the Commission resorted to here. For insider trading to violate Rule 10b-5 as a fraud, there must be a fiduciary duty owed to the person from whom information is misappropriated. Such a duty is a prerequisite to illegal trading because the fraud statutes are violated by "[d]eception through non-disclosure."[121] A "fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information." *O'Hagan*, 521 U.S. at 652. But where there is no fiduciary duty, there is no disclosure obligation so there is no deception from non-disclosure. "[O]ne who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so."[122] Rule 10b-5(2), which describes three examples of relationships that would constitute a duty under the misappropriation theory, is consistent with this well-established rule.[123]

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purchased out-of-the-money options 13 different times and increased the value in his IRA by approximately 86%, all by trading call options.

[119] *In re David W. Baldt*, Rel. No. 418, 2011 WL 1506757, at *18 (S.E.C. Apr. 21, 2011).

[120] Div. Ex. 1 ¶ 73.

[121] *United States v. O'Hagan*, 521 U.S. 642, 654 (1997).

[122] *Chiarella v. United States*, 445 U.S. 222, 228, 229, 231 (1980).

[123] In its commentary describing the purpose of Rule 10b-5(2), the Commission noted that Rule 10b-5(2) was consistent with case law, which "already establishes a regime under which questions of liability turn on the nature of the details of the relationships between family members, such as their prior history and patterns of sharing confidences." 65 Fed. Reg. 51716-01, 51729-30 (Aug. 24, 2000). Courts have also observed that requiring a "history or pattern of

While Toby does not deny the Complaint's allegation that he owed and violated a fiduciary duty to his girlfriend, that allegation reflected an aggressive legal theory. The Division never alleged that Toby and his girlfriend had a history of sharing confidential business information, as is required to establish a fiduciary duty based on a personal relationship where there is no allegation of an agreement to maintain confidences.[124] In fact, the evidence establishes that no such history existed.[125] Likewise, the Division has not alleged, because no evidence would support, that they held jointly owned assets, shared bank accounts, shared credit cards, or co-signed leases or other legal documents. Nor has the Division cited to a single case in which a boyfriend and girlfriend were found to have a fiduciary relationship where they had no history, pattern, or practice of sharing confidential business information with each other.

A non-expert in this field could not have known that the relationship between Toby and

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sharing *business* confidences" that were generally maintained to establish a duty between spouses is consistent with Rule 10b-5(2). *See Securities & Exchange Commission v. Yun*, 327 F.3d 1263, 1273 & n.23 (11th Cir. 2003) (emphasis added).

[124] *See* Div. Ex. 1 ¶ 60 (alleging that Toby and his girlfriend had history of sharing "personal and confidential" information with each other); *cf Yun*, 327 F.3d at 1273 (the SEC must prove that a husband and wife had a history or practice "of sharing business confidences"); Complaint, *Securities & Exchange Commission v. Edelman*, 06-cv-0021 (S.D.N.Y. Jan. 3, 2006) (Ex. 11) (involving insider trading allegations brought against a boyfriend accused of misappropriating insider information from his live-in girlfriend and describing them as having "a history, pattern or practice of sharing confidential *work* and personal information") (emphasis added). *See also Securities & Exchange Commission v. Conradt*, 947 F. Supp. 2d 406, 407-08 (S.D.N.Y. 2013) (fiduciary duty exists between an equities analyst and his close friend where they had "shared numerous *professional* confidences") (emphasis added); *United States v. Corbin*, 729 F. Supp. 2d 607, 616-17 (S.D.N.Y. 2010) (indictment sufficiently alleged that the functional equivalent of a fiduciary relationship exits where it alleged a relationship between spouses "that involved the repeated disclosure of *business* secrets") (emphasis added).

[125] Toby's girlfriend testified that she does not remember ever telling Toby the name of the target and she has not been accused of tipping. *See, e.g.*, Ex. 17 at 89:3-90:20 (on one occasion Toby asked his girlfriend if she knew whether Disney had shown interest in a number of companies, one of which was Marvel. Proving that she was careful not to share business confidences with Toby, she said "no, I haven't heard that," even though at the time she was aware that Disney was interested in Marvel); *see also id.* at 42:12-22 (Toby's girlfriend testified: "Obviously, I didn't tell [Toby] who the target was" because she "knew it was confidential.").

his girlfriend would support the application of the misappropriation theory. And an expert could dispute that it does. Regardless, there is no allegation or proof that Toby was aware of the applicability of the theory when he traded.

Further countering the position that the degree of scienter was significant enough to warrant a bar, Toby was young, inexperienced, and was neither a registered investment advisor nor a licensed broker.[126] For these reasons, the degree of scienter alleged in this case weighs against a bar.

4. The Sincerity of Toby's Assurances Against Future Violations Weighs Against a Bar

Toby has taken steps to ensure he will not violate securities laws in the future. In response to the Division's investigation, he stopped trading altogether and has no intention of ever trading on his own behalf again.

Toby has learned from this process. At the time of the suspect trades, he was, without any guidance or formal training, experimenting with trading strategies that he had essentially taught himself. He did not appreciate the regulatory risk associated with making these trades and exercised poor judgment when he traded in Marvel under suspicious circumstances. His trades warranted the Commission's investigation. Toby recognizes that and appreciates the role the Division plays in enforcing securities laws and regulations.[127]

The consequences of Toby's actions have been life-altering and severe. He lost his job at Madrone Advisors and his career path has been permanently altered. The Division's Complaint

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[126] *See, e.g.*, *Jantzen*, 2012 WL 5422022, at *5 (imposing a 5-year bar and noting that a high degree of scienter was demonstrated by evidence showing the defendant was a "licensed securities broker" so "certainly knew what he was doing," and that he created an alibi to hide his trades).

[127] AA 45 ¶ 5.

received significant negative media attention and anyone who searches Toby's name on the Internet will find countless news articles calling him a fraud. The investigation is, and will continue to be, a constant source of humiliation and a significant burden. He has already paid huge legal bills. He is permanently enjoined from violating securities laws and will be subjected to a judgment that requires payment of disgorgement and civil penalties. He is also under criminal indictment.

Toby has assured that he will take steps to avoid violations in the future.[128] Therefore, this factor weighs against a bar.

5. Toby's Recognition of the Wrongful Nature of His Conduct Weighs Against a Bar

Without admitting or denying the truthfulness of the Complaint's allegations, Toby recognizes that in making the Marvel trades, he exercised a lapse in judgment and put himself and loved ones in a position warranting the Division's investigation.[129]

As already noted, shortly after the Division filed its complaint against him, Toby posted the "Secfail.com" website, which criticized the Government's investigation. Immediately after entering into the consent agreement, however, he took the website down. He has not spoken out against the Division since. The website was a misguided effort to defend himself against scathing one-sided media coverage. Toby apologizes for posting it and for its needlessly personal attacks on the staff.[130] Notably, however, the Web site was posted prior to the issuance of the district court's order and prior to Toby's consent to that order. Up until he settled with the Division, he

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[128] *Id.* ¶ 8.
[129] *Id.* ¶ 7.
[130] *Id.* ¶ 9.

had every right to speak out publicly on his own behalf, as the Division spoke out publicly against him. His methods were immature and inappropriate, but they do not warrant a bar.

Toby was not convicted or found guilty of any crime or violation and he is not required to admit the allegations in the civil complaint. Even so, he acknowledges and understands that the Marvel trades were a mistake. He should never have made them. In doing so, he failed to appreciate the regulatory risk involved with trading and thus raised suspicions that warranted the Division's investigation. He recognizes the wrongful nature of his conduct and vows he will take efforts to prevent it happening again.[131]

6. Toby's Occupation Is Unlikely to Present Opportunities for Future Violations

Aside from the fact that Toby deeply regrets ever having made the trades in question and is determined to avoid violating securities laws in the future, there is little likelihood that he would have the opportunity to do so. Toby does not work in the securities industry and at this time has no intention of working in the securities industry. He founded a start-up company and is dedicated to helping that company grow into a successful business. Furthermore, the trades at issue had nothing to do with his occupation at the time and Toby has ceased trading on his own behalf.

A bar would be unfair here not because it would prevent Toby from working in the securities industry – as already noted, he currently has no plans to do so – but because of the additional reputational harm it would cause him and the collateral harm it would cause to his new company and career. Because it is unlikely that Toby's occupation will present opportunities for future violations, this factor weighs against a bar.

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[131] *Id.* ¶¶ 5, 7, 8.

7. A Bar is Not Necessary to Achieve Deterrence

A bar is not a necessary deterrent. Toby has already suffered severe consequences as the result of his actions and has stopped trading on his own behalf. Moreover, he lost his job, has agreed to pay penalties and disgorgement (money he does not currently have), and has paid expensive legal bills. Any personal or general deterrence that might occur as a result of the Commission's treatment of this case has already been achieved.[132]

Nor do the circumstances justify imposition of a collateral lifetime bar. A collateral bar is only warranted where the *alleged misconduct* "is of the type that, by its nature, 'flows across' various securities professions and poses a risk of harm to the investing public in any such profession."[133] Toby is accused of making a personal trade based on nonpublic insider information alleged to be related to a single deal. The nature of the alleged misconduct does not "flow across" various securities professions. A collateral bar is therefore unwarranted. This Court also regularly imposes less than a lifetime collateral bar even where, unlike the case at hand, securities violations have been proven.[134] The test, as articulated above, is the weight of the *Steadman* factors.[135] Here, those factors weigh against imposition of a lifetime collateral bar.

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[132] *See Bauer*, 2013 WL 1646913, at *4 (circumstances, including consequences resulting from litigation, warranted less than lifetime bar).

[133] *Sayegh*, 1999 SEC LEXIS 639, at *18-19.

[134] *See, e.g., Bauer*, 2013 WL 1646913 (seven-month suspension following civil court's finding that defendant committed insider trading); *Jantzen*, 2012 WL 5422022 (five-year bar in follow-on proceeding related to insider trading); *In re Thomas C. Bridge*, Rel. No. 60736, 2009 WL 3100582 (S.E.C. Sept. 29, 2009) (three-year bar, five-year bar); *Furman*, 2012 WL 2339281, at *7 (seven-year bar); *Sloate*, 1997 WL 126707, at *3 (overturning initial imposition of one-year bar and deciding that in light of the circumstances, a five-year bar was more appropriate; rejecting imposition of collateral bar for same reasons); *Puccio*, 1996 WL 603681, at *1 (five years); *Radano*, 2008 WL 257440, at *1 (five years).

[135] For example, in cases cited *supra* n.134, the difference of length in bars was due to variations in the strength and quantity of *Steadman* factors satisfied.

V. THE HEARING OFFICER ERRED IN DISREGARDING THE NATURE OF TOBY'S EMPLOYMENT AT THE TIME OF THE TRADES

The hearing officer erroneously concluded that it did not matter for purposes of determining whether a sanction was in the public interest that the alleged violations had nothing to do with Toby's work for a purported investment adviser. Toby argued that the nature of his employment at the time of the trades in question should be considered as one of the circumstances relevant to determining whether a sanction was in the public interest. The hearing officer, however, appears to have concluded as a matter of law that such considerations should not be taken into account.[136]

To support this position, however, the Decision relies entirely on cases in which a respondent was barred based on a criminal conviction, and observes that "the Commission has long barred individuals based on convictions involving dishonesty that are not even securities-related."[137] But Toby has never been convicted of anything, and his trades in Marvel are entirely unrelated to the Commission's exercise of jurisdiction over him. It is only his employment at Madrone that makes it possible for the Commission to bar him in the first place, and that employment had nothing to do with the trades at issue, and is entirely unrelated to his current or future employment. The Commission should be able to weigh that fact in determining whether a sanction is in the public interest, and, in fact, it weighs against a bar.[138]

Neither the hearing officer nor the Division cited any support for the argument that it is improper to consider the nature of the respondent's employment in considering whether a bar is in the public interest. And it is not improper. The fact that the alleged conduct is unrelated to

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[136] *See* Decision at 4-5.

[137] *Id.* at 4.

[138] *Kornman*, 2009 WL 367635, at *9 (the appropriate sanction "depends on the facts and circumstances of each case").

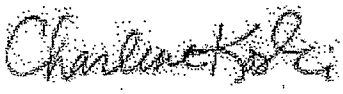
Toby's work at Madrone speaks to a lack of egregiousness – Toby is not accused of violating any duty of confidentiality or trust to his employer or abusing his position there in anyway. It also weighs against any argument that Toby's occupation presents opportunities for securities violations – the conduct at issue here was completely unrelated to his occupation, he no longer works for Madrone, and he no longer trades on his own behalf.[139] And it weighs against finding a high degree of scienter, as his profession did not provide any related training or expertise.[140]

VI. CONCLUSION

For reasons stated herein and in Toby's briefing before the hearing officer, and based on the entire record in connection with both parties' motions, this Court should reverse the Initial Decision, deny the Division's motion for summary disposition, and grant Toby's.

DATED: January 16, 2014

Respectfully submitted,



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[139] *See, e.g.*, *Steadman*, 603 F.2d at 1139 (listing factors courts consider in determining whether a sanction is in the public interest, including egregiousness of the underlying violation and likelihood that defendant's occupation will present opportunities for future violations; *see also Kornman*, 2009 WL 367635, at *9 (the appropriate sanction "depends on the facts and circumstances of each case").

[140] *See, e.g.*, *Jantzen*, 2012 WL 5422022, at *5 (imposing a 5-year bar and noting that a high degree of scienter was demonstrated by evidence showing the defendant was a "licensed securities broker" so "certainly knew what he was doing").