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UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of: J.S. OLIVER CAPITAL MANAGEMENT, L.P., IAN O. MAUSNER, and DOUGLAS F. DRENNAN	Administrative Proceeding File No. 3-15446

BRIEF OF J.S. OLIVER CAPITAL MANAGEMENT, L.P. AND IAN O. MAUSNER IN SUPPORT OF PETITION FOR REVIEW

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INTRODUCTION AND SUMMARY OF ARGUMENT

This case presents the question whether the District of Columbia Circuit's decision in *Rapoport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012)—which requires a "reasoned explanation" and consistency across cases—will impose any real restraint on administrative decisions that order penalties. The petitioners here are an investment adviser, Ian O. Mausner, and the firm, J.S. Oliver Capital Management, L.P. ("JS Oliver"), that Mausner operated out of his house. The Initial Decision (*J.S. Oliver Capital Mgmt., L.P.,* Initial Dec. Rel. No. 649 (Aug. 5, 2014)) orders penalties against adviser and firm totaling more than $18 million—a figure that exceeds total ordered disgorgement (of $1.4 million) by more than $16 million. Because of the huge excess of the penalty over other relevant dollar figures, this case is a stark outlier.

It is, therefore, an ideal vehicle—not a borderline case, but an extreme one—for the Commission to show that *Rapoport* means what it says: that ALJs must set out a specific and substantial predicate before they impose any penalty, much less a penalty so out of line with other cases. To satisfy *Rapoport* and related authorities, the Initial Decision had to explain its penalty calculations with particularity. It also had to show that its calculation method is appropriate and consistent with other cases. And it had to show that the penalty amount is consistent with penalties imposed in other cases.

The Initial Decision does none of these. It does not, as required, articulate a legal basis for the method it uses to calculate the penalties. In fact, the Initial Decision mixes inconsistent methods within the same case—and does not justify that mixing of methods by providing the required "reasoned explanation." *Rapoport,* 682 F.3d at 104. Nor does the Initial Decision attempt to square its calculation methods with those used in other cases.

The Initial Decision also fails to justify the sheer size of the penalty, which sticks out sharply from other cases involving investment professionals and the antifraud provisions of the securities laws. Typically, the maximum penalty bears some identifiable, proportional relationship to other dollar figures in a case, particularly the respondent's gain. The Initial Decision makes a sharp break from this pattern by imposing a penalty that exceeds pecuniary gain by more than $16 million. Yet the Initial Decision provides no reason this matter warrants a penalty that is so much higher, in the context of the case, than penalties in the vast majority of cases. *Rapoport* requires that the Commission explain this difference and reconcile the penalty with other cases. The Initial Decision fails to do so.

Because the Initial Decision suggests no possible justification for a penalty higher than the pecuniary gain to Mausner and JS Oliver, the respondents ask the Commission to order penalties that do not exceed the amount of disgorgement recommended in the Initial Decision. In the alternative, the Commission should remand this matter with instructions to the law judge. Those instructions should require the law judge to recommend penalties that do not exceed pecuniary gain to the respondents; to adopt an interpretation of a statutory "act" that is internally consistent and demonstrably consistent with other cases; and to explain the basis for the penalty amount in a way that reconciles that amount with penalties in other cases.

STATEMEMENT OF THE ISSUE

The governing legal standards require that the Commission explain penalty calculations by articulating the basis for the penalty and explaining how the penalty calculation and amount are consistent with other cases. The issue presented is whether the Initial Decision meets these requirements, where it:

- calculates the penalty by switching between two different methods of counting statutory violative "acts," but does not explain the legal basis for either method; and
- orders a total penalty that is an extreme outlier relative to other cases, without explaining why this outlier penalty is warranted or how it is consistent with the pattern demonstrated by other cases.

STATEMENT OF FACTS

Petitioners JS Oliver Capital Management LP and Ian C. Mausner

JS Oliver is a registered investment adviser, founded in 2004 and located in San Diego, California. Initial Dec. ("Dec.") at 2–3. Mausner, also an investment adviser, is JS Oliver's chief executive officer, portfolio manager, and principal decision maker. *Id.* at 3, 40. During the relevant years of 2005 to 2011, the firm was located in one room on the first floor of a house; during some of that time, Mausner also lived in the house. *Id.* All of the conduct for which the Initial Decision holds JS Oliver responsible was undertaken by Mausner.

The Initial Decision

The Order Instituting Proceedings ("OIP") was issued in August 2013. Dec. at 1. In January 2014, the law judge conducted a five-day hearing. During the earlier proceedings in this matter, Ian O. Mausner appeared *pro se,* and appeared for JS Oliver as well. *Id.* The law judge issued her Initial Decision about six months after the hearing, in August 2014. She concluded that JS Oliver and Mausner violated the anti-fraud provisions of Securities Act Section 17(a), 15 U.S.C. § 77q(a); Exchange Act Section 10(b) and Rule 10b-5, 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5; Advisers Act Sections 206(1), 206(2), and 206(4), 15 U.S.C. §§ 80b-6(1), (2), (4); and Rule 206(4)-8, 17 C.F.R. § 275.206(4)-8. Dec. at 38-51.

The trading-allocation and soft-dollar violations

The law judge found that these violations occurred through two kinds of activities. The first involved the allocation to clients of the firm's trading profits and losses. The Initial Decision concludes that Mausner made block trades of securities and allocated the trades to clients after the fact, disproportionately assigning profitable trades to favored clients and unprofitable trades to disfavored clients ("cherry picking"). *Id.* at 2, 40-41, 48. The favored clients, the Initial Decision stated, included hedge funds in which Mausner had invested. *Id.* at 5-6, 40-41. The law judge found that this conduct reduced the profits of the disfavored investors by $10.9 million. *Id.* at 11. The law judge also concluded that JS Oliver made material misstatements to clients about this trading activity. *Id.* at 39-42, 46.

The second activity involved client commission credits called "soft dollars." OIP at 2, 4-8. Soft dollars are credits or rebates that broker-dealers provide to investment advisers, typically for the investment advisers to use on research, brokerage, and related services for their clients. *See* Exchange Act § 28(e), 15 U.S.C. § 78bb(e)(1) (establishing safe harbor for certain uses of soft dollars). The Initial Decision concluded that JS Oliver and Mausner used about $1.1 million of soft-dollar payments for the following impermissible purposes: to make payments to Mausner's former wife; to pay rent for the office in Mausner's home, at an excessive rate; to make impermissible payments to an employee (payments amounting to $482,381, which went to the employee rather than to Mausner); and to pay for a timeshare that Mausner used for personal as well as business purposes. Dec. at 32, 46. The law judge also concluded that JS Oliver and Mausner failed to make required disclosures to clients about the use of soft dollars. *Id.* at 42-47, 48.

The law judge further concluded that JS Oliver and Mausner willfully violated certain recordkeeping and compliance requirements: first, the recordkeeping requirements of Advisers Act Section 204, 15 U.S.C. § 80b-4(a), and Rule 204-2(a)(3), 17 C.F.R. § 275.204-2(a)(3), by failing to maintain certain trading records; second, the preservation requirements of Advisers Act Section 204, 15 U.S.C. § 80b-4(a), and Rule 204-2(a)(7), 17 C.F.R. § 275.204-2(a)(7), by failing to preserve certain email messages; third, the requirements of Advisers Act Section 206(4), 15 U.S.C. §§ 80b-6(4), and Rule 206(4)-7, 17 C.F.R. § 275.206(4)-7, by failing to adopt written policies and procedures reasonably designed to prevent fraud and to undertake other compliance activities; and fourth, the requirements of Advisers Act Section 204, 15 U.S.C. § 80b-4(a) and Rule 204-1(a)(2), 17 C.F.R. § 275.204-1(a)(2), by failing to amend JS Oliver's Form ADV when that report became inaccurate. Dec. at 51. The law judge also concluded that JS Oliver and Mausner willfully violated Advisers Act Section 207, which prohibits untrue statements in the firm's Form ADV. *Id.* at 52.

Sanctions recommended by the Initial Decision

The Initial Decision then addresses sanctions. First, it orders the most severe available bar: a permanent bar of Mausner from the securities industry. *Id.* at 53-56. It also recommends the most severe available sanction against JS Oliver: revocation of JS Oliver's registration as an investment adviser. *Id.*

Second, it recommends a cease-and-desist order against JS Oliver and Mausner. *Id.* at 56-57.

Third, it recommends disgorgement by JS Oliver and Mausner, jointly and severally, of $1,376,440 plus prejudgment interest. This reflects the law judge's calculation of the "ill-gotten gains," *id.* at 57, of JS Oliver and Mausner, though the disgorgement amount includes the

$482,381 that was paid to an employee (Douglas F. Drennan) rather than to Mausner. *Id.* at 57-59. (Of this amount, $482,381 is joint and several with Douglas F. Drennan. *Id.* at 58).

Fourth and finally, the Initial Decision recommends penalties. For JS Oliver, it recommends a penalty of $14.975 million, and for Mausner a penalty of $3.040 million—for total penalties to Mausner and his company of $18.015 million. *Id.* at 62. The law judge calculated the penalty amounts as follows. The law judge calculated penalties separately for the trade allocations and for the soft-dollar uses. For the trade allocations, she divided the time frame by months, declaring that this activity constituted one "act," and therefore one violation per month. *Id.* at 61. This generated a count of 18 violations. *Id.* For the soft-dollar activity, she declared that JS Oliver and Mausner had committed one violation for each purpose for which they had misused soft dollars. *Id.* She counted each category as a single "act." *Id.* at 60-61. This generated a count of four separate violations. *Id.* at 61. Then, to reach the penalty amounts that she recommended, the law judge multiplied the total of 32 violative "acts" by the applicable statutory maximum for each act. *Id.* at 60. The number of violative acts identified by the law judge therefore determined the total amount of the penalties.

The Petition for Review

After the law judge issued her Initial Decision, JS Oliver and Mausner filed a Petition for Review. The Commission granted the Petition by Order dated October 7, 2014.

ARGUMENT

THE INITIAL DECISION DOES NOT COMPLY WITH THE REQUIREMENTS FOR IMPOSING ANY PENALTY—MUCH LESS FOR IMPOSING A PENALTY SO HIGH IT IS AN OUTLIER

I. The Commission Is Required To Articulate The Rationale For A Penalty—In Particular For A Penalty That Is Severe—And Must Reconcile The Penalty With Those Imposed In Other Cases

When the Commission imposes a penalty, it must provide "a reasoned explanation" for its decision, *Rapoport*, 682 F.3d at 104, setting forth the decision's basis "with such clarity as to be understandable," *id.* (quoting *SEC v. Chenery Corp.*, 332 U.S. 194, 196-97 (1947)). *Accord The Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1099 (D.C. Cir. 2005) (vacating civil penalties "because the SEC did not explain its reasoning" for the sanctions or "even cursorily explain" why the necessary elements for such sanctions were satisfied); *see also Jost v. Surface Transp. Bd.*, 194 F.3d 79, 85 (D.C. Cir. 1999) ("The requirement that agency action not be arbitrary and capricious includes a requirement that the agency adequately explain its result.").

The Commission also must demonstrate that it "consistently" applies the law across cases. *Rapoport*, 682 F.3d at 104. The Commission simply cannot "depart from [its] precedent without explaining why." *Id.* In this case, the Commission must explain how the penalty calculation method and the resulting amount are consistent with other cases. *Id.*; *accord Collins v. SEC*, 736 F.3d 521, 526 (D.C. Cir. 2013) (recognizing review under the arbitrary-and-capricious standard "requires consideration of whether the sanction is out of line with the agency's decisions in other cases"). Finally, the Commission also must explain why the penalty is warranted in light of other sanctions imposed, including why other sanctions imposed will have the desired punitive effect. *See SEC v. Conaway*, 697 F. Supp. 2d 733, 771-72 (E.D. Mich. 2010) (citing cases); *accord SEC v. Universal Express, Inc.*, 646 F. Supp. 2d 552, 568-69 (S.D.N.Y. 2009).

The burden to provide a reasoned explanation is greater when—as in this case—the penalty is severe. "[W]hen the Commission chooses to order the most drastic remedies at its disposal, it has a greater burden to show with particularity the facts and policies that support those sanctions and why less severe action would not serve to protect investors." *Steadman v.*

SEC, 603 F.2d 1126, 1137 (5th Cir. 1979). *Steadman* thus identifies three distinct elements of the Commission's additional burden in cases involving severe penalties: (1) it bears a "greater burden" to give an explanation "with particularity"; (2) the particularized explanation must describe "facts and policies" that support a sanction that is "drastic"; and (3) the explanation must expressly state why a "less severe" sanction would not suffice. *Id.*

II. The Initial Decision Does Not—And Cannot—Provide The Required Explanation For The Method It Used To Calculate The Penalties

The Initial Decision violates these requirements. It does not justify its calculation methodology—which is, at best, unusual. The Initial Decision mixes two different methods of counting violative "acts;" it does not justify either method (much less its mixing of the two); and it does not explain how its calculation method is consistent with other cases.

A. The Initial Decision mixes two different interpretations of a statutory violative "act," and it does not provide the required reasoned basis for either interpretation, much less for mixing the two

The statute sets out the method for calculating penalties, identifying a maximum penalty in terms of the number of violative "acts." *See* 15 U.S.C. § 78u-2(b)(3); 15 U.S.C. § 80b-3(i)(2)(C). It does not define "act." The Initial Decision uses two different meanings of the word: one for the soft-dollar conduct and a different one for the trade-allocation conduct.

For the soft-dollar conduct, the Initial Decision identifies an "act" in terms of the *nature* of the activity. This conduct involved numerous transactions over a period of up to 18 months. Dec. at 2 n.2. The Initial Decision deems the conduct to constitute four "acts," on the theory that the various payments went to four ultimate recipients. *Id.* at 61. The Initial Decision does not explain this approach, as *Rapoport* requires, nor does it identify any authority for it. *Id.*

The Initial Decision uses a different method to calculate the penalty relating to allocation of trades. Instead of combining all conduct of an arguably similar nature into a single violative "act" (as it does for the soft-dollar conduct), the Initial Decision divides the trading activity into units of *time*. The Initial Decision selects a month as the relevant unit of time, and deems all relevant conduct carried out during a calendar month a separate statutory "act." *Id.* This leads to a count of 18 violations, *id.*, thus contrasting with the four violations for the soft-dollar activity that also continued for 18 months, *id.* at 22-45.

As with the soft-dollar calculation, however, the Initial Decision does not say why it used this interpretation of "act." It cites *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1314-1315 (S.D. Fla. 2007), which it misreads as saying that the per-month approach is "reasonable." Dec. at 61. *KW Brown* does note in passing that the per-month approach would be compatible with the vague statutory word "act," but it does not say the per-month approach would be appropriate in that case—or ever. 555 F. Supp. 2d at 1314-15. The court suggests to the contrary: It did not use the per-month method because it focused on the proper amount of the total penalty, and concluded that a reasonable total penalty was lower than one calculated on the one-act-per-month method. *Id.* It ordered a penalty equal to the defendant's pecuniary gain and to the disgorgement amount in that case. *Id.* This reasoning—using defendant's pecuniary gain as a reference point for the maximum penalty—is precisely the pattern that we explain in section III.A. below.

B. The Initial Decision does not—and cannot—show that its interpretation of a statutory violative "act" is consistent with the approach taken in other cases

The Initial Decision therefore fails to give a reasoned explanation for either of its methods of counting violative "acts." While this statutory term is a flexible one, *Rapoport* requires that the Initial Decision's interpretation be well-explained and consistent with other cases. 682 F.3d at 104.

Relevant cases often use interpretations of "act" entirely unlike those in the Initial Decision. In *Rapoport*, for example, the Commission defined "acts" in terms of the passage of time, but it chose the unit of a year rather than a month—a measure that is one-twelfth as harsh as the method the Initial Decision used for the trade-allocation conduct. *Id.* at 102. And the D.C. Circuit expressed serious doubt about defining a statutory "act" based on *any* unit of time, remanding for further consideration on the point. *Id.* at 108.

Collins illustrates another interpretation of "act." In that case, where the respondent continued his fraudulent marketing for multiple years, 736 F.3d at 523-24), the Initial Decision deemed that all of the fraudulent conduct constituted a total of one violation, *id.* at 524. When the Commission reviewed that decision, it changed to another approach: It found one violations for each customer that Collins had defrauded, increasing the number of violations to five. *Id.*

In *Raymond J. Lucia Companies, Inc.*, Initial Dec. Rel. No. 540 (Dec. 6, 2013), the respondent had engaged in conduct involving misleading multiple seminars and various marketing activities that had reached as many as 50,000 people. *Id.* at 8. This conduct continued for at least 36 months. *Id.* at 61 n.41. Even though "the Respondents technically violated the statute hundreds of times," the law judge treated the entire course of conduct as a single violative act—on the theory that this approach led to a reasonable total penalty. *Id.* at 60-61.

Another recent example is *optionsXpress, Inc.*, Initial Dec. Rel. No. 490 (June 7, 2013), a decision by Chief Judge Murray. There, one respondent was a clearing firm that had violated a short-sale regulation approximately 1,200 times across at least 10 months. *Id.* at 101. As in *Raymond J. Lucia*, the Initial Decision determined the number of violative "acts" by beginning with the conclusion: It first chose a total penalty that seemed appropriate, then used that desired outcome to identify the number of acts that would lead to it.

Thus the law judge first stated that a "literal application of the 'each act or omission' language [of the statute] would have an absurd result" (*id.* at 101), apparently because applying any substantial penalty amount to each violation would have led to a total penalty in the hundreds of millions of dollars. The law judge then decided that a "reasonable outcome" for the firm was a total penalty of $2 million. *Id.* Next, she stated that this amount would be reached by finding one violative "act" per each of the 1,200 transactions and setting the penalty per transaction at $1,667. This per-violation amount contrasts sharply with our case, where the law judge used the statutory maximum for the firm of $725,000 or $650,000 per act (depending on the year of the violation) (Dec. 60)—a figure up to *435 times* as high as the $1,667-per-penalty figure used in *optionsExpress*. ($725,000 ÷ $1,667 = 435.)

The Initial Decision in our case does not explain this difference. Nor does it explain why it counts stock-allocation violations on a per-month basis rather than use any of the other approaches noted above: a per-year basis (as in *Rapoport*), a per-transaction basis (as in *Collins*), or an entire-course-of-conduct basis—counting all relevant conduct as one single "act" (as the law judge did in *Collins* and as in *Raymond J. Lucia*). Or, as in *optionsXpress*, counting every transaction as a violation but discounting the per-violation penalty (as little as $1,667 each) to less than one percent of that in our case (up to $725,000 each).

Also in our case, even imposing internal consistency would have changed the penalty amounts. For example, had the Initial Decision defined violative "acts" for the trading-allocation penalty based on the on the *nature* of the conduct at issue, as it did with the soft-money transactions, the law judge could have found one violation instead of 18. This simple change would have reduced the recommended penalty by about $13.9 million—even if, unlike this same law judge's opinion in *optionsXpress*, the law judge imposed the maximum penalty per act.[1] Or, if the Initial Decision had followed the pattern of the Commission's opinion in *Collins* and counted one act for each client affected, it would have counted three acts relating to trading allocation rather than 18. Dec. 6 (concluding that the trading disadvantaged three customers). This change would have reduced the penalty relating to trading allocation by more than $12 million (again, even if the law judge continued to impose the maximum penalty per act).[2]

These choices had momentous consequences for the size of the penalty, but the Initial Decision gives no explanation for them. Should the penalty be $1 million or should it be $14.9 million? Or $6 million? The law judge chose precisely $18.015 million. The answer appears to depend heavily on the number of "acts" the law judge chose to declare. If there is such a thing as an unexplained, arbitrary decision, surely this is it. It does not meet *Rapoport*'s "rational explanation" and consistency requirements and should, therefore, be rejected.

III. The Initial Decision Does Not—And Cannot—Provide The Required Explanation For The Penalty Amount

A. Other penalty decisions reflect a well-established pattern, in which maximum penalties bear a proportional relationship to other dollar figures in a case

So the Initial Decision fails to justify its *method* for calculating a penalty. It also fails to justify the penalty *amount*. That amount is well out of line with those in relevant precedents, but the Initial Decision does not explain why an outlier penalty is warranted or how it is consistent with penalties in other cases.

[1] The reduction would be approximately: (10 months times $130K) plus (7 months times $150K) plus (10 months times $650,000) plus (7 months times $725K.) = $13.925 million.
[2] The reduction would be approximately: (10 months times $130K) plus (5 months times $150K) plus (10 months times $650,000) plus (5 months times $725K) = $ 12.175 million.

It is true that "[t]he Commission is not obligated to make its sanctions uniform," *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004), and nothing requires that a penalty amount bear a specific relationship to other dollar figures in the same case. But it is equally true that *Rapoport* requires consistency across cases, 682 F.3d at 104, and other cases show that maximum penalties typically bear a proportional relationship to other dollar figures in a case, particularly to the respondent's gain. Acknowledging this pattern therefore gives teeth to the consistency requirement.

This is unmistakable in the relevant precedents, though illustrating it requires that we review a number of cases. A good starting point is a Commission opinion cited by the Initial Decision, *In the Matter of Peter Siris,* Exchange Act Rel. No. 71068 (Dec. 12, 2013). This matter involved an investment adviser who had engaged in "numerous instances" of fraudulent conduct relating to ten different offerings of a Chinese reverse-merger company. *Id.* at 10. The violations included misrepresentations that were "egregious and recurrent," *id.*, and continued for two years, *id.* Yet in the underlying district-court proceeding, the court had imposed a penalty that was less than the disgorgement amount: disgorgement of $592,942 and a penalty of $464,011. Final Judgment, *SEC v. Siris*, No. 12-cv-5810 (S.D.N.Y. Sep. 18, 2012), ECF No. 4 at 5.

The same proportionality ceiling on penalties is evident in administrative decisions. One example is *optionsXpress*, which we also noted above (because it deemed every transaction a separate violation but imposed a very small penalty per violation). *optionsXpress* involved repeated fraudulent conduct ("naked short" sales) that included more than 1,000 transactions across at least 15 months. Rel. No. 490, at 3, 101. Two respondents received third-tier penalties: for the first respondent, disgorgement was $1.57 million and the penalty was $2 million (so that penalty exceeded disgorgement by 27%); for the second respondent, disgorgement was $2.65

million and penalty was $2 million (so that penalty was less than disgorgement). *Id.* at 103-104. Critically, the law judge *began* the penalty calculation by identifying a total penalty that would not be "absurd" and would, in fact, be "reasonable." *Id.* at 101. She identified this figure as $2 million, *id.*, a total penalty figure that falls neatly in the range of benefit to the two respondents ($1.57 million and $2.65 million). Put slightly differently, total disgorgement was $4.2 million and total penalties were slightly less, at $4 million.

Another recent case, *In the Matter of Daniel Bogar*, Initial Dec. Rel. No. 502 (Aug. 2, 2013), involved three executives at a broker-dealer owned by Allen Stanford. They violated antifraud provisions over a three-year period by, among other things, helping to make material misrepresentations to investors. *Id.* at 25. The law judge deemed their conduct "egregious." *Id.* at 29. At the hearing, they denied any wrongdoing. *Id.* at 31. The law judge ordered disgorgement for the three respondents of $592,000, $1.5 million, and $2.6 million, respectively. *Id.* at 1. To calculate penalties, the law judge divided each respondent's conduct into only two "courses of action." *Id.* at 31-32. He then ordered each respondent to pay a (third-tier) penalty of $260,000—much less than the disgorgement figures. *Id.*

In cases where gain to the respondent is low or minimal, the maximum penalty typically bears a reasonable connection to the dollar magnitude of the case. Thus, a Commission opinion from earlier this year addressed a fee-based investment-adviser who had represented to clients that he was independent; those representations were false because he took payments for steering client investments to an investment manager. *In the Matter of Montford and Company, Inc.*, Investment Advisers Act Rel. No. 3829, at 2 (May 2, 2014). This fraud went on for about a year and a half (just as in our case). *Id.* at 31. The Commission found the conduct "particularly egregious" and "antithetical to the fiduciary duties." *Id.* at 41. At the hearing, the individual respondent was "not credible." *Id.* at 32. The Commission ordered disgorgement of $210,000 (jointly and severally against firm and principal), *id.* at 36-39, which did not cover all improper benefits the respondents had received (*id.* at 39-40). The Commission calculated the penalty by deeming the conduct to constitute only two violative "acts." *Id.* It ordered third-tier penalties of $500,000 against the firm ($290,000 more than disgorgement) and $150,000 against the individual (less than disgorgement), *id.* at 39-41.

Similarly, another recent order (also issued since the D.C. Circuit's opinion in *Rapoport*) involved the principal of a broker-dealer who carried out a fraudulent scheme that went on for about a year, misleading investors into purchasing at least $500,000 of misrepresented securities. *In the Matter of Johnny Clifton*, Securities Act Rel. No. 9417, at 3-4 (July 12, 2013). The fraud was "egregious and recurrent." *Id.* at 20. The Commission ordered no disgorgement because the fraud did not lead to substantial gain for the respondent, though the fraud had "created a significant risk of substantial losses to investors." *Id.* at 24. The Commission counted all of the respondent's conduct as one single "act" and ordered a total (third-tier) penalty of $150,000. *Id.* at 2, 25.

Another example is *Raymond J. Lucia*, Rel. No 540, which we discussed above for its interpretation of the statute's reference to "act." It deemed three years of violative conduct to be a single "act." This case did not involve disgorgement, but it did involve a penalty that the law judge considered reasonable in light of the other dollar amounts. The law judge explained that calculating penalties by counting each fraudulent seminar as a separate violative "act"—an interpretation permitted by the statute's reference to "act"—would have led to a penalty of $87 million against one respondent and $18 million against the other. *Id.* at 61 n.41. He rejected those possible totals based on the context of that case, expressly invoking proportionality: "Such penalties would plainly be disproportionate and unreasonable." *Id.* (The $18 million figure that Judge Elliott rejected as "plainly disproportionate" is less than the total penalties that the law judge recommended in our case.) Although it appears that the respondents obtained a minimum of $1.1 million from the fraudulent activities, *id.* at 5-7, 41, the law judge imposed a penalty of $250,000 on the firm and $50,000 on the individual, *id.* at 1.

Proportionality also is evident in cases brought in federal court.[3] Some courts have reasoned that, in cases that involve other severe sanctions such as an industry ban, full disgorgement, and pre-judgment interest, it would be excessive to impose a penalty that reaches the level of the disgorgement amount. *See, e.g.*, *Conaway*, 697 F. Supp. 2d at 771-72 (SEC's request for penalty equal to disgorgement was excessive in light of amount of disgorgement and pre-judgment interest) (citing cases); *Universal Express,* 646 F. Supp. 2d at 568-69 (civil penalties equal to disgorgement would "exceed[] the additional punishment required" and thus were unnecessary in light of disgorgement and prejudgment interest).

It also is common for courts to impose a penalty as large as the defendant's pecuniary gain. For example, the Initial Decision in our case cites *K.W. Brown* (which we discussed above to explain that it does not endorse a per-month definition of "act" to generate the amount of penalty). The Initial Decision, at 40-41, 53, apparently considers *K.W. Brown* factually similar to our case: *K.W. Brown* also involves "cherry-picking," which was a fraud on clients to whom the *K.W. Brown* defendants owed a fiduciary duty. 555 F. Supp. 2d at 1289-91, 1303-04. That cherry-picking continued for 46 months (more than twice as long as the 18 months in our case).

[3] The statute governing penalties imposed by courts differs slightly from the provision applicable to administrative proceedings, 15 U.S.C. § 78u-2(a), because it presents an option to impose a penalty equal to the defendant's gain, *see* 15 U.S.C. § 78u-(d)(3)(B)(iii)(II), but that provision did not come into play in this context. *SEC v. Pentagon Capital Mgmt. PLC*, 2012 U.S. Dist. LEXIS 43046, at *12 (S.D.N.Y. Mar. 28, 2012), for example, specifically noted that it had the ability to impose a penalty much higher than the amount of benefit to the defendant.

Id. at 1315. The fraud caused about $9 million of injury to investors. *Id.* at 1278. (The figure in our case is $10.9 million. Dec. 41.) The defendants then gave false testimony at the hearing. *K.W. Brown*, 555 F. Supp. 2d at 1296. Based on these facts, and as we explained in section II.B above, the court selected a penalty amount expressly because it matched the benefit to the defendants: $4.5 million. *K.W. Brown*, 555 F. Supp. 2d at 1312-15.

A recent decision from the Southern District of New York, *SEC v. Pentagon Capital Mgmt. PLC*, discussed the relationship between disgorgement and penalties in securities enforcement cases brought in federal court. 2012 U.S. Dist. LEXIS 43046, at *22-23, (S.D.N.Y. Mar. 28, 2012), *vacated in part on other grounds*, 725 F.3d 279 (2d Cir. 2013). The court was refuting a respondent's argument that the penalty must be less than disgorgement. *Id.* at *21. As *Pentagon Capital Mgmt.* explained, courts do often impose penalties that rise to the level of the disgorgement amount, *id.* at *18–23 (collecting cases in which penalty was equal to or less than disgorgement)—though the *Pentagon Capital* court also noted precedents where third-tier penalties were much *less* than the benefit to the respondent, *id.* at *18–20. The court also noted that the statute authorized it to impose penalties exceeding the benefit to the respondent, *id.* at *9–12, but did not cite any cases that did so.

The *Pentagon Capital* court also expressly invoked proportionality. In that case, an investment-adviser firm and its principal had orchestrated a scheme to defraud mutual funds through late trading and deceptive market timing, making more than 10,000 illegal trades across two-and-a-half years and benefiting themselves by about $38 million. *Id.* at *2–3. Because of the seriousness of the conduct, the court imposed a penalty as large as the benefit the defendants had obtained through their fraud—but no larger. *Id.* at *12. (The court noted that the statute would have permitted penalties of more than $6 billion and $1 billion. *Id.* at *7–8.) The court reasoned that this penalty was "proportionate to the pecuniary gain" to the defendants. *Id.* at 12.

One very recent federal case departs from the overall pattern by imposing a very high penalty relative to disgorgement—but it does not square this penalty with other decisions. In an opinion issued in August of 2014, the U.S. District Court for the Eastern District of Tennessee imposed sanctions on a broker-dealer, its holding company, and one of their senior officers. *SEC v. AIC, Inc.*, 2014 U.S. Dist. LEXIS 105146, at *2 (E.D. Tenn. Aug. 1, 2014). The court ordered disgorgement of $2.8 million and $6.6 million against the entities, but much higher penalties of $27.95 million against each. *Id.* at *20-21, *26. Against the principal, it ordered disgorgement of nearly $1 million and penalties of $1.505 million. *Id.* at *20, *28-29.

The court did not even acknowledge that this decision breaks from the pattern in the above administrative and judicial cases. Indeed, the court cited eight cases in its discussion of the penalty amount and, far from supporting the high penalty the court imposed, those cases reinforce the pattern that we described above. One of the cited cases involved a penalty that was higher than the disgorgement amount, and that was by all of $475,000. *SEC v. Tourre*, 4 F. Supp. 3d 579, 583-584 (S.D.N.Y. 2014) (ordering disgorgement from former Goldman Sachs executive of about $175,000 and penalty of $650,000). Another involved disgorgement for three defendants of $9,551, zero, and zero, and penalties of $25,000, $50,000, and $25,000, *SEC v. Moran*, 944 F. Supp. 286, 296 (S.D.N.Y. 1996). Every other cited case involved a penalty that was equal to disgorgement or lower (sometimes much lower). Thus, in *SEC v. Kern*, 425 F.3d 143, 153 (2d Cir. 2005), disgorgement was $7 million and penalty was only $1.1 million; in *SEC v. Bravata*, 3 F. Supp. 3d 638, 662-63, (E.D. Mich. 2014), disgorgement was $5.2 million and penalty was less than 3% of that figure, at $130,000; in *SEC v. Murray*, 2013 U.S. Dist. LEXIS

32460, *18-19 (E.D.N.Y. Mar. 6, 2013), penalty was equal to disgorgement; in *Pentagon Capital*, 2012 U.S. Dist. LEXIS 43046, at *22-23 (which we discussed above), penalty was equal to disgorgement; in *SEC v. Opulentica*, 479 F. Supp. 2d 319, 324, 331 (S.D.N.Y. 2007), disgorgement was $443,962 and penalty was just over a fourth of that amount, at $120,000; and in *SEC v. Salyer*, 2010 U.S. Dist. LEXIS 85545, *12, *15 (E.D. Tenn. Aug. 18, 2010), disgorgement was more than $5.7 million and penalty was $130,000—less than 3% of the disgorgement amount. *AIC* could never pass muster under *Rapoport* and *Collins*.

B. The Initial Decision does not—and cannot—explain how the outlier penalties that it orders are consistent with this pattern

Despite the lone exception in *SEC v. AIC*, the practice of relying on proportionality is unmistakable. As we saw, some judges even make their use of proportionality explicit, invoking it to explain their decisions (*e.g., Raymond J. Lucia; Pentagon Capital Mgmt*). And though Chief Judge Murray did not use the word, she relied on proportionality to identify an appropriate penalty in *optionsExpress*.

Viewed against the pattern formed by the cases, the penalty in our case sticks out as a multi-million-dollar aberration. And in a matter with an outlier result, the *Rapaport* requirement for a "reasoned explanation" is especially important. And as the *Steadman* court cautioned the SEC, "the greater the sanction the Commission decides to impose, the greater is its burden of justification." 603 F.2d at 1139. That admonition certainly applies here. To give a "reasoned explanation" for this outlier penalty, the Commission would have to: (1) distinguish this case from the many others that implicate the same statutory factors as ours but impose penalties that are proportionately much lower, (2) explain how the proposed penalty is, in fact, consistent with the pattern of penalties established by those other cases, and (3) explain why lesser sanctions would not suffice. *Collins,* 736 F.3d at 526; *Rapoport*, 682 F.3d at 104; *Steadman*, 603 F.2d at 1137. The Initial Decision does none of these.

We do *not*, however, contend that governing authorities impose a dollar ceiling on penalties based on any particular relationships within a case. (The D.C. Circuit rejected that contention in *Collins*, 736 F.3d at 525-26.) We contend, as explained in the preceding section, that the quantitative relationships within cases are relevant because they provide a basis to make comparisons across cases. An outlier penalty is permissible, but only if the Commission can justify it by laying the necessary predicate: by providing a detailed explanation that meets the requirements of *Rapoport*, *Steadman*, and related authorities.

The Commission cannot ignore this pattern and remain faithful to *Rapoport*. The *Collins* court made this point when it reminded the SEC that, although the court will not apply "mechanical formulae" to penalty decisions, it will take into account "history and precedent" in penalty cases. *Id.* at 526. This "history and precedent" demonstrate that penalty amounts consistently reflect proportionality within cases. Proportionality is, therefore, the best available basis to compare consistency across cases. We cannot test consistency by checking whether cases use the statutory word "act," since "act" is susceptible to such a broad range of meanings, and its vagueness is compounded by the penalty statute's use of a test that is multi-factorial. (*See* factors listed at 15 U.S.C. § 78u-2(c)).

Yet the whole point of the *Rapoport* requirements is to impose some restraint on the facts-and-circumstances discretion that the law often affords the Commission. *Rapoport* imposes that restraint through its "explanation" and "consistency" requirements; ignoring those requirements would render *Rapoport* toothless. It also would, in effect, reject the District of Columbia Circuit's repeated demands for rationality and consistency.

Providing the required explanation is hardly onerous—that is, if the decision at issue is susceptible to a satisfactory explanation. Applied to a decision imposing a penalty, for example, *Rapoport* requires only that the law judge make explicit the reasoning that often is present but implicit. Providing that explanation does not appear to be possible in our case, however, because in light of the "history and precedent" that we set out in the preceding section, the penalty decision in our case is well "out of line with the agency's decision in other cases." *Collins*, 736 F.3d at 526.[4]

This case is, therefore, unlike *Collins*, where the D.C. Circuit ultimately held that the penalty at issue was not out of line with penalties in other cases. *Id.* The total penalty in *Collins* was only $310,000, *id.* at 524—about 1.7% of the total penalty in our case. And in contrast with the Commission opinion at issue in *Collins*, the Initial Decision has multiple failings. It imposes a penalty that is so high, relative to other points of reference in the case, that it requires an explanation of how it could be reconciled with the penalties in those other cases. The Initial Decision does not give that explanation. Nor does the Initial Decision articulate a method for calculating the penalty that is appropriate, as we explained in section II above. These problems were not present in *Collins*.

Also unlike *Collins*, in our case the penalty-to-disgorgement *ratio* does not provide useful information. This is because the disgorgement figure in our case (the baseline for the ratio) is far larger than that in *Collins*—472 times as large. (Disgorgement in our case is $1,376,440 (Dec. at 63), and in *Collins* was all of $2,915 (736 F.3d at 524).) Because the disgorgement figure is so

[4] In a similar vein, the Initial Decision also fails to take into account the other sanctions it imposed, *Conaway*, 697 F. Supp. 2d 771-72 (citing cases). Those sanctions are as severe as they can be: full disgorgement and a lifetime ban (as well as a cease-and-desist order). Yet the Initial Decision gives no explanation of why, in light of these other sanctions, it is appropriate to impose penalties that even match disgorgement amount, much less exceed it.

much larger, even a small multiple of that figure generates a penalty that is huge. In *Collins*, by contrast, because of the low disgorgement figure, even a high multiple of that figure generated a penalty that was, relative to our case, quite small ($310,000).

If instead of looking at the *ratio*, we consider the *actual* excess of penalty-over-disgorgement, the figure in *Collins* is only about $308,000, while the figure in in our case is about $16.6 million. This is about 54 times the excess in *Collins*. By this measure, the penalty in our case is out of line in a way that the penalty in *Collins* is not.

Finally, the unusually large penalty ordered in the Initial Decision could not be justified by a need to deter or punish Mausner or JS Oliver, especially in light of the disgorgement, permanent bar, and cease-and-desist sanctions also imposed. This case does not involve a large financial institution, against which the Division might need to seek a huge fine to send an adequate message in light of the institution's huge size; this case involves an individual and the firm that operated out of a room in his house. Dec. at 3. And the record establishes that neither firm nor principal have substantial assets. According to the Initial Decision, he could have been forced into bankruptcy over $2 million of an earlier judgment. *Id.* at 14. Indeed, in the administrative proceeding that led to the Initial Decision, JS Oliver and Mausner proceeded *pro se*.

IV. To Show That *Rapoport* Must Be Taken Seriously, The Commission Should Set Aside The Recommended Penalties And, Based On The Facts Of This Case, Order A Penalty No Larger Than The Benefit To The Respondents

For these reasons, nothing in the Initial Decision or the record suggests that penalties any higher than pecuniary gain to the respondents are warranted. The Commission should set aside the recommended penalties and impose a penalty no higher than a total of $1,376,440, jointly and severally imposed on Mausner and JS Oliver.[5] This approximates the payments that the Initial Decision concluded, went to JS Oliver or Mausner, though as we explained above, this figure exceeds the pecuniary gain to Mausner and JS Oliver; not only did $482,381 in payments go to Drennan, Dec. at 57-59, some of the payments at issue, such as a portion of the rent, were earned. For that reason, the disgorgement figure of $1,376,440 leads to a penalty figure that is higher than the actual pecuniary gain from the conduct that, the Initial Decision found, violated the law.

CONCLUSION

For the reasons set out above, respondents JS Oliver and Ian O. Mausner respectfully request that the Commission set aside the penalties ordered in the Initial Decision, and that penalties ordered by the Commission on JS Oliver and Ian O. Mausner shall not exceed the total of $1,376,440. This is the amount of disgorgement recommended in the Initial Decision (and which, as we noted in the above Statement of Facts, exceeds the payments Mauser received by at least $482,381).

In the alternative, JS Oliver and Ian O. Mausner respectfully request that the Commission remand this matter with instructions to the law judge. Those instructions should require that the law judge recommend penalties that are no greater in total than $1,376,440; adopt an interpretation of a statutory "act" that is internally consistent as well as consistent with other cases; and justify the basis for the penalty amount in a way that explain how that amount is consistent with the penalties in other cases. *Id.*

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[5] *See* SEC Rules of Practice, 17 C.F.R. § 201.411 ("Rule 411"); Rule 411(a) ("The Commission may … modify, set aside, or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper"), (b)(2)(ii)(B) ("a conclusion of law that is erroneous"), and (b)(2)(ii)(C) ("an exercise of discretion or decision of law or policy that is important and that the Commission should review").

Respectfully submitted,

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: J.S. OLIVER CAPITAL MANAGEMENT, L.P., IAN O. MAUSNER, and DOUGLAS F. DRENNAN	Administrative Proceeding File No. 3-15446

CERTIFICATE OF SERVICE

I, Andrew J. Morris, hereby certify that, pursuant to Rule 150(c)(2) of the United States Securities and Exchange Commission's Rules of Practice, on November 7, 2014, I caused a true and correct copy of the J.S. Oliver Capital Management, L.P. and Ian O. Mausner Brief in Support of Petition for Review of Initial Decision to be served upon the following persons according to the method specified for each:

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November 7, 2014

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Washington, D.C. 20549

Re: JS Oliver Capital Management, L.P. and Ian O. Mausner (File no.3-15446)

Dear Office of the Secretary:

Enclosed for filing are the original and three copies of the Brief of J.S. Oliver Capital Management, L.P. and Ian O. Mausner in Support of Petition for Review of Initial Decision.

If there are any questions regarding this filing, please contact the undersigned. Thank you for your assistance.

Very truly yours,

Andrew J Morris

Andrew J. Morris

Enclosures
cc: The Honorable Brenda P. Murray
David J. Van Havermaat, Esq.