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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15514

In the Matter of

FRANK H. CHIAPPONE,
ANDREW G. GUZZETTI,
WILLIAM F. LEX,
THOMAS E. LIVINGSTON,
BRIAN T. MAYER, and
PHILIP S. RABINOVICH,

Respondents.

DIVISION OF ENFORCEMENT'S SUPPLEMENTAL REPLY BRIEF

Respectfully submitted,

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PRELIMINARY STATEMENT

Main Street investors who rely on brokers for investment recommendations have long been protected by the fundamental duty of all brokers to have a reasonable basis for investment recommendations. Indeed, by making a recommendation, a broker implicitly represents that he or she has done an investigation and has an adequate basis for the recommendation. And under longstanding precedent, a broker's failure to investigate before recommending a security violates the antifraud provisions of the federal securities laws.

Respondents Frank Chiappone, William Lex, Thomas Livingston, Brian Mayer, and Phillip Rabinovich—who were among the top-selling brokers at McGinn, Smith & Co. ("MS & Co.")—violated this fundamental duty. Livingston was also a part-owner and high-level manager at MS & Co. Respondents recommended and sold approximately $82 million of fraudulent, unregistered, in-house private placements (the "McGinn Smith Securities") to hundreds of retail investors as part of the long-running MS & Co. Ponzi scheme. David Smith and Timothy McGinn are now serving long prison sentences for their roles in the fraud. Respondents recommended the McGinn Smith Securities without conducting any reasonable investigation—notwithstanding glaring red flags—and by misrepresenting and omitting material facts about those investments. Their supervisor, Andrew Guzzetti, also ignored red flags and failed reasonably to supervise. These actions caused their customers to lose millions of dollars.

After an eighteen-day hearing in early 2015, Chief ALJ Murray issued an Initial Decision ("ID") finding that Chiappone, Lex, Livingston, Mayer, and Rabinovich violated the antifraud provisions of the federal securities laws, and that Guzzetti failed reasonably to supervise. On March 30, 2018, in response to a Commission Order, the ALJ issued an Order Revising and Ratifying Prior Actions (the "March 2018 Order"), finding Respondents Chiappone, Lex,

Livingston, Mayer, and Rabinovich violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 5(a) and 5(c) and 17(a) of the Securities Act of 1933, by recommending and selling the McGinn Smith Securities. She also found that their supervisor, Guzzetti, failed reasonably to supervise. These findings are well supported by the record. Respondents now appeal that decision, and the ID, upon which it rests.

Consistent with the Commission's April 20, 2018 Supplemental Briefing Order (the "Supplemental Briefing Order"), the Division of Enforcement addresses only those arguments which have not been stated by Respondents in previous briefing before the Commission. Thus, the Division does not address such issues as whether Section 5 of the Securities Act requires scienter, whether 28 U.S.C. § 2462 bars this proceeding, and whether Respondents raise valid equal protection and due process claims. Those issues, and others, have been amply addressed in:

- Division of Enforcement's Brief in Response to Respondents' Joint Brief, filed October 1, 2015;
- Division of Enforcement's Brief in Response to Respondents' Individual Briefs, filed October 1, 2015; and
- Division of Enforcement's Letter to the Commission, dated August 7, 2017, responding to letters submitted by certain Respondents in July 2017 and addressing the impact of recent federal court decisions on the relief awarded by ALJ Murray.

The six Respondents raise four new challenges to the March 2018 Order and the Initial Decision, none of which warrants reversal.

First, Respondents' constitutional claims are unavailing. Respondents incorrectly claim that the Commission's November 30, 2017 Ratification Order (the "Ratification Order") and the ALJ's March 2018 Order are invalid. Contrary to Respondents' assertions, the Commission cured any constitutional infirmity flowing from the appointment of its ALJs when it ratified those prior appointments and set forth a process to allow the ALJs to review and consider

whether to ratify their prior decisions—a process that Chief ALJ Murray correctly followed in issuing the March 2018 Order. Respondents' assertion that ALJs' two tiers of removal protection violates the separation of powers similarly fails because it is the type of limited restriction on the removal power that the Supreme Court has long countenanced.

Second, one Respondent seeks to narrow the scope of a broker's duty to investigate based on an unreported March 2018 federal court decision. That decision is distinguishable, however, and does not provide a basis to disturb Chief ALJ Murray's finding that Respondents committed fraud.

Third, Mayer and Rabinovich's argument that the Supreme Court's decision in *Kokesh v. SEC* somehow affects the Commission's statutory authority to award disgorgement ignores the clear language of Section 21B(e) of the Exchange Act, conferring this authority.

Fourth, Lex, Mayer, and Rabinovich's argument that prejudgment interest would be punitive due to the length of these proceedings misunderstands why the Commission imposes interest on disgorgement awards: to deprive Respondents of any unjust enrichment from the ill-gotten gains they secured by defrauding their customers.

ARGUMENT

I. Respondents' Constitutional Claims Lack Merit.

A. The Commission's Ratification Order and the ALJ's March 2018 Order Are Valid.

1. The Commission's Ratification Order.

In its Ratification Order, the Commission properly "ratifie[d] the agency's prior appointment" of its ALJs. Ratification allows for the "adoption and affirmance by one person of an act which another, without authority, has previously assumed to do for him." 1 Floyd R. Mechem, *A Treatise on the Law of Agency* § 347 (2d ed. 1914); *Black's Law Dictionary* (10th

ed. 2014) (ratification renders an act "valid from the moment it was done"). The "ratification of an unauthorized act is deemed to be equivalent to a prior authority to perform it." Floyd R. Mechem, *A Treatise on the Law of Public Offices and Officers* § 545 (1890). A ratification "may be inferred" from the parties' conduct, 1 *A Treatise on the Law of Agency*, § 430, and may be "written or unwritten, express or implied," *A Treatise on the Law of Public Offices and Officers*, §§ 545, 547.

Two factors are critical in determining whether a principal has validly ratified an agent's previously unauthorized act. First, the principal must have had the authority to perform the act, both when the agent undertook it and at the time of ratification. *See* 1 *A Treatise on the Law of Agency*, §§ 347, 354, 374; *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994); *United States v. Heinszen & Co.*, 206 U.S. 370, 382 (1907); Restatement (Third) of Agency § 4.04(1) & cmt. b (2006). Second, the conduct of the principal must lead a third party to "reasonably . . . conclude that the act of another in [the principal's] behalf has been adopted and sanctioned" by the principal. Floyd R. Mechem, *A Treatise on the Law of Agency* § 146 (1888).

Those factors are satisfied here. Both at the time of the initial appointment and when it issued its Ratification Order, the Commission was authorized to appoint its ALJs. *See* 5 U.S.C. § 3105 (agencies "shall appoint as many administrative law judges as are necessary"); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010) (Commission is a Head of Department empowered to appoint inferior officers.). The Commission indisputably could have made the initial appointments itself, and it is beyond doubt that it can, and has, "adopted and sanctioned" those actions when it "ratifie[d] the agency's prior appointment" of its ALJs.

Courts have uniformly endorsed ratification in analogous circumstances. In *Edmond v. United States*, 520 U.S. 651 (1997), petitioners sought to overturn convictions that had been affirmed by military judges whose appointments had been deemed invalid in an earlier decision. The Supreme Court rejected petitioners' challenge because an appropriate official had cured the constitutional error by "adopting" the judges' appointments "as judicial appointments of [his] own" before the judges had affirmed the convictions. *Edmond*, 520 U.S. at 654, 666. Other courts have likewise upheld ratifications following Appointments Clause and other constitutional challenges. *E.g.*, *CFPB v. Gordon*, 819 F.3d 1179, 1190-92 (9th Cir. 2016), *cert. denied*, 137 S. Ct. 2291 (2017); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 115-16, 118-19 (D.C. Cir. 2015); *Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203, 212-14 (D.C. Cir. 1998); *FEC v. Legi-Tech, Inc.*, 75 F.3d 704, 709 (D.C. Cir. 1996).

Respondents' claim (*e.g.*, Rabinovich Br. 12)[1] that the Ratification Order is invalid because "the Commission never appointed th[e] ALJs in the first place" misunderstands the nature and purpose of ratification. As explained above, the doctrine allows a principal to authorize prior actions taken by an agent who acted outside the scope of his or her authority. Here, agency staff approved the initial hiring of the Commission's ALJs. To the extent that action exceeded the scope of the hiring officials' authority, the defect was remedied by the Commission's Ratification Order.

The suggestion that there is insufficient evidence of the appointments to render them valid (Livingston Br. 8) is similarly flawed. An appointment is valid upon the "performance of such public act" that "create[s] the officer" and "enable[s] him to perform the duties" of the office. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 156 (1803). While an appointment may be

[1] Respondents' briefs submitted pursuant to the Supplemental Briefing Order are referred to herein as "[Respondent's Name] Br."

evidenced by a presidential commission, it also may be shown by some other "open" and "unequivocal" act. *Id.* at 156-57. Here, the personnel actions approving the hiring of the ALJs amply satisfied the "public act" requirement and empowered the ALJs to exercise the functions of their office, as did the Commission's Ratification Order ratifying those appointments.

2. The ALJ's Ratification Decision: the March 2018 Order.

Respondents mistakenly contend (*e.g.,* Guzzetti Br. 6) that a new proceeding is necessary because the ratification procedures the Commission prescribed—and the ALJ applied—did not remedy their alleged harm. As directed, Chief ALJ Murray conducted a de novo review of the entire administrative record and issued a lengthy decision ratifying in part, and revising in part, her prior actions. March 2018 Order. Her considered approach and thoughtful analysis—which reduced the disgorgement amounts for certain Respondents, *see* March 2018 Order at 29—is more than sufficient to evince a valid ratification.

Indeed, courts have consistently upheld ratification decisions made after comparable reviews. *E.g., Intercollegiate Broadcasting Sys.*, 796 F.3d at 118-19 (de novo record review sufficient for valid ratification; "new hearing" not required); *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 602-03 (3d Cir. 2016) (ratification valid where action taken with "full knowledge of the decision to be ratified" and reflected "a detached and considered affirmation of the earlier decision"). And courts have routinely upheld ratification decisions made after far less rigorous procedures than those applied here. *See CFPB v. Gordon*, 819 F.3d 1179, 1186, 1192 (9th Cir. 2016) (Director's "Notice of Ratification" simply "affirm[ed] and ratif[ied]" prior actions and the challenger offered no evidence that the Director failed to make a detached and considered judgment concerning matters he ratified); *FEC v. Legi-Tech*, 75 F.3d at 709.

Nor are Respondents correct that the ALJ's ratification order is invalid because Section 706 of the Administrative Procedure Act (APA) requires that agency findings not in accordance with the law must be set aside. *E.g.*, Chiappone Br. 16-17. As discussed above, the whole point of ratification is to render a prior act valid from the moment it was initially done. Respondents' contrary theory would eliminate the possibility of ratification any time the proceeding involved the APA. And because there is no need for a new proceeding, Respondents' claim that any such proceeding would be barred by the statute of limitations necessarily fails. *E.g.*, Lex Br. 8; Chiappone Br. 17; Rabinovich Br. 10. Respondents similarly err in asserting that the statute of limitations precluded the ALJ from ratifying her decisions relating to conduct that had occurred more than five years before the ratification decision. Chiappone Br. 17. The Order Instituting Proceedings in this case was issued by the Commission within the statute of limitations. Because the constitutionality of the *Commissioners'* appointments is undisputed, the OIP was and remains valid and does not require ratification, regardless of any initial defect in the appointments of the Commission's ALJs.

B. The ALJ Removal Protections Do Not Violate the Constitution.

Respondents wrongly assert that the statutory removal protections for the Commission's ALJs violate constitutional separation of powers.[2] *E.g.*, Rabinovich Br. 13. Article II of the Constitution vests "[t]he executive Power . . . in a President of the United States of America," who must "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 1, cl. 1; *id.*, § 3.

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[2] Respondents' inclusion of this claim preserves it for further review. *See* 15 U.S.C. § 78y(a)(1) (if "aggrieved by a final order of the Commission," respondents may raise any preserved challenge before a court of appeals). But adjudicating the constitutionality of congressional enactments "has generally been thought beyond the jurisdiction of administrative agencies." *Elgin v. Dep't of the Treasury*, 567 U.S. 1, 16 (2012). Thus, while a federal court would be the ultimate arbiter of this type of constitutional claim, the Division nevertheless submits this response to explain that Congress's longstanding removal protections for ALJs do not violate the separation of powers.

Unlike its specific directives governing the power of appointment, "[t]he Constitution is silent with respect to the power of removal from office, where the tenure is not fixed." *Ex parte Hennen*, 38 U.S. 230, 258 (1839). The "power of removal" nonetheless has been viewed as "incident to the power of appointment." *Id.* at 259; *see also Myers v. United States*, 272 U.S. 52, 164 (1926) (the Constitution implicitly reserves to the President the "power of removing those for whom he cannot continue to be responsible").

The Supreme Court has long recognized that Congress may impose limited restrictions on the removal power. Congress may, for example, impose a for-cause removal restriction on the President's power to remove principal officers of certain independent agencies. *See Free Enter. Fund*, 561 U.S. at 493-94. And the Court has countenanced for-cause limitations on a principal officer's ability to remove inferior officers. *Id.* at 494.

In *Free Enterprise Fund*, however, the Court held that the "novel" and "rigorous" barrier to removing members of the Public Company Accounting Oversight Board by the Commission, whose members are presumed to enjoy "for cause" removal protection, left the President with insufficient ability to supervise the PCAOB's execution of the laws. 561 U.S. at 496. The Court noted that it had "previously upheld limited restrictions on the President's removal power" but only where "one level of protected tenure separated the President from an officer exercising executive power." *Id.* Two levels of "for cause" removal for an officer exercising "executive power," the Court held, "result[s] i[n] a Board that is not accountable to the President, and a President who is not responsible for the Board." *Id.*

But contrary to Respondents' insistence, *Free Enterprise Fund* does *not* compel the conclusion that the statute providing that the Commission ALJs may be removed only for "good cause," 5 U.S.C. § 7521, violates the separation of powers for two reasons.

First, in his brief in *Raymond J. Lucia, et al. v. Securities & Exchange Commission* (S. Ct. No. 17-130),[3] the Solicitor General offered an interpretation of ALJs' "good cause" removal protection that comports with constitutional constraints. Brief for Resp. Supporting Petitioners, *Lucia v. SEC*, No. 17-130 (U.S. argued Apr. 23, 2018), 2018 WL 1251862 ("Solicitor General Br."). Drawing from constitutional avoidance principles, the Solicitor General explained that, even where ALJs are embedded "in a structure involving more than one layer of tenure protection," a proper construction of "good cause" may alleviate constitutional concerns. Solicitor General Br. at 51.

The statutory scheme, the Solicitor General explained, must be understood to allow "[a]gency heads [to] be able to remove ALJs who refuse to follow agency policies and procedures, who frustrate the proper administration of adjudicatory proceedings, or who demonstrate deficient job performance." Solicitor General Br. at 47. Under this view, Section 7521 should be "interpreted to permit an agency to remove an ALJ for personal misconduct or for failure to follow lawful agency directives or to perform his duties adequately." *Id.* at 45. At the same time, an ALJ may not be removed " 'at the whim or caprice of the agency or for political reasons,' " *id.* at 49 (quoting *Ramspeck v. Federal Trial Exam'rs Conference*, 345 U.S. 128, 142-43 (1953)), and "an ALJ would still be protected from removal for invidious reasons otherwise prohibited by law," *id.* at 50.

According to the Solicitor General, that interpretation of Section 7521 passes constitutional muster—and avoids the constitutional defects at issue in *Free Enterprise Fund.* There, "the PCAOB's members could be removed only under an 'unusually high standard' that required a 'willful' violation of the law, a 'willful' abuse of their authority, or an 'unreasonable'

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[3] The corresponding reply brief is available at Reply Brief for Resp. Supporting Petitioners, *Lucia v. SEC*, No. 17-130 (U.S. argued Apr. 23, 2018), 2018 WL 1806836.

failure to enforce legal requirements"; here, by contrast, "[t]he intrusion on presidential authority is significantly less." Solicitor General Br. at 51 (quoting *Free Enterprise Fund*, 561 U.S. at 503). "ALJs could accordingly be held accountable, by the Heads of Departments and the President who appointed them, for failure to execute the laws faithfully." *Id.* at 51.[4]

Second, *Free Enterprise Fund* is distinguishable for another reason. Crucial to the Court's decision to invalidate the dual for-cause structure in that case was the fact that PCAOB Board members exercised quintessential "executive" functions—and not solely "quasijudicial" functions. 561 U.S. at 496, 502, 505, 507 n.10. Indeed, the Court refused to extend its holding to ALJs, who "of course perform adjudicative rather than enforcement or policymaking functions, or possess purely recommendatory powers." *Id.* at 507 n.10 (internal citation omitted). The Solicitor General in *Lucia* similarly drew a line between quasijudicial duties and purely executive functions when he explained that the President, acting through principal officers, cannot remove an ALJ "to influence the outcome in a particular adjudication," and noted the need to "respect[ ] the independence of ALJs in adjudicating individual cases." Solicitor General Br. at 45, 50.

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[4] The Solicitor General also stated that Section 7521(a)—which allows for removal "only for good cause established and determined by the Merit Systems Protection Board [MSPB] on the record after opportunity for hearing before the Board,"—should be construed so that "the MSPB's review is limited to determining whether factual evidence exists to support the agency's proffered good faith grounds." Solicitor General Br. at 39, 52. Such an approach ensures that the Department Head retains primary control in the decision to remove an ALJ. But the Commission need not address this aspect of the statutory scheme; regardless of how the MSPB's role in the removal process is understood, agencies like the Commission "possess the authority to reassign responsibilities away from ALJs while awaiting MSPB review of a removal decision." *Id.* at 53, 55. Consequently, "[t]hat authority avoids the possibility that an ALJ might continue to adjudicate cases beyond the point at which the Department Head has lost confidence in the ALJ's ability to exercise appropriate judgment." *Id.* at 55.

That is reflective of the Supreme Court's longstanding recognition that Congress's ability to enact limited removal protections depends in part on the functions of the office being created. In *Wiener v. United States*, 357 U.S. 349 (1958), for example, the Court upheld statutory removal restrictions of War Claims Commission members because the members performed "quasijudicial" rather than purely executive functions. *Id.* at 353-54. And in *Morrison v. Olson*, 487 U.S. 654 (1988), the Court upheld good-cause restrictions on the removal of an "independent counsel," who was an executive officer with the power to investigate allegations of crime by high officers, because the restrictions provided structural independence necessary to the proper functioning of the particular office, and the independent counsel had "limited jurisdiction and tenure and lack[of] policymaking or significant administrative authority." *Id.* at 689-91, 695-96.

Accordingly, Congress has the latitude to impose removal restrictions to ensure the structural independence necessary for ALJs to properly perform their quasijudicial functions—which is precisely what the Commission explained when rejecting a removal challenge premised on *Free Enterprise Fund. See Timbervest, LLC*, Rel. No. 4197, 2015 WL 5472520, at *27 (Comm'n Op. Sept. 17, 2015).

II. The ALJ Properly Applied the Broker's Duty to Investigate.

Citing an unreported decision March 2018 from a district court in Florida, *SEC v. Betta*, No. 09-80803-CIV-MARRA, 2018 U.S. Dist. LEXIS 55909 (S.D. Fla. Mar. 30, 2018), Chiappone argues that the ID constitutes an "unwarranted extension" of *Hanly v. SEC*, 415 F.2d 589 (2d Cir. 1969), and that "the ALJ expanded *Hanly* to impose a duty to investigate in the absence of affirmative misrepresentations and omissions." Chiappone Br. at 3-6. Chiappone is wrong.

As explained at length in the Division's 2015 briefs, a broker's duty to investigate has been well-established for decades as a result of Commission opinions, FINRA rules, and federal court decisions. Recent decisions only affirm the importance of this duty. *See, e.g., SEC v. CKB168 Holdings, Ltd.*, 210 F. Supp. 3d 421, 449 n.31 (E.D.N.Y. 2016) (granting SEC's motion for summary judgment and stating "by acting as brokers, each of the promoters acquired heightened duties to investigate and disclose. A broker is under a duty to investigate the truth of his representations to clients, because by his position he implicitly represents he has an adequate basis for the opinions he renders") (internal quotation and citation omitted); *Matter of Bernerd E. Young*, Rel. No. 4358, 2016 WL 1168564, at *15 & n.60 (Comm'n Op. Mar. 24, 2016) (affirming "duty to investigate" and rejecting respondent's claim that it was reasonable for him to fail to investigate a portfolio and rely instead on a letter from compliance staff to the Commission, especially where the respondent had encountered red flags).

Although Chiappone argues that the facts in *Betta*—which does not cite *Hanly*—are "strikingly similar," *Betta* involved much different facts. In *Betta*, the brokers recommended Collateralized Mortgage Obligations ("CMOs") that were issued by Fannie Mae, Ginnie Mae and Freddie Mac. 2018 U.S. Dist. LEXIS 55909, at *10. In contrast, the Respondents recommended unregistered McGinn Smith Securities—securities issued by entities controlled entirely by Smith and McGinn, who also controlled the broker-dealer, trusts and placement agents. Brookstreet, the broker-dealer firm in *Betta*, was "a large, national firm" with 300 offices, 750 registered representatives, and "a centralized, fully staffed and active legal and compliance department." 2018 U.S. Dist. LEXIS 55909, at *161. MS & Co., in contrast, was a small regional firm with two offices and was controlled in all aspects by Smith and McGinn. The *Betta* court also found that the CMO program was "closely monitored by the firm's compliance

and legal department," *id.* at *163, while there is no evidence that MS & Co.'s understaffed compliance and legal department monitored the McGinn Smith Securities to the extent that Brookstreet's compliance and legal departments monitored the CMOs. Indeed, for much of the relevant period, Smith himself was the Chief Compliance Officer. Guzzetti Ex. 2, at 1, 3.

Another critical distinction is that the *Betta* court found no evidence of red flags or knowledge of wrongdoing and concluded that the brokers made their recommendations "in good faith and they had a reasonable basis to make those recommendations." 2018 U.S. Dist. LEXIS 55909, at *165. In contrast, the ID and the Division's 2015 briefs cite to substantial evidence proving that each Respondent, at a minimum, recklessly failed to investigate in the face of red flags and made customer recommendations with no reasonable basis.

To cite just some of this evidence, Chiappone drafted an email to Smith in 2008 which described Smith's "market meltdown" excuse regarding the Four Funds default as a "nice screen for the fact that you had mismanaged the assets that my clients and I entrusted in your care." Div. Resp. Indiv. Br. at 12. Lex knew in 2007 that Smith had lied to him about the diversification of the Four Funds, that Smith was using new investor funds to pay off prior investors, and Lex emailed Smith in March 2009 that his customers had called MS & Co. "a Ponzi scheme." *Id.* at 18-20. Livingston emailed Smith in December 2007, after learning of the "obvious conflicts" of interest and $45 million in losses, that MS & Co. was "teetering on the brink of calamity." *Id.* at 23-24. Mayer and Rabinovich knew that customers were being redeemed with new investor funds, including by Rabinovich. *Id.* at 29-36. And Guzzetti, whose supervisory role is proven by dozens of his own emails, the firm's written supervisory procedures, and the testimony of his co-Respondents, played a critical role in ensuring that no redemption was paid unless new investor funds were coming in. *Id.* at 44-45.

Finally, the brokers in *Betta* could point to a wide array of "emails, conference calls, informational marketing materials, and information contained on Brookstreet's website" as providing a reasonable basis. 2018 U.S. Dist. LEXIS 55909, at *162. None of the Respondents can point to similar evidence. Indeed, the evidence shows that the Respondents did nothing to investigate the fraudulent securities they recommended other than rely upon Smith and McGinn. And as *Hanly* and other cases make clear, when the brokers' sole source of information about an unregistered and illiquid security is also the issuer of that security, the broker's duty to investigate is heightened. Here, the Respondents failed to fulfill even a basic duty to investigate, let alone the heightened duty that was called for. This constitutes recklessness.

III. The Commission Has Authority to Award Disgorgement in this Matter.

The argument by certain Respondents that the Commission, may not, as a matter of law impose disgorgement misses the mark. *See, e.g.,* Rabinovich Br. at 16; Mayer Br. at 16. The Supreme Court in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) stated that "[n]othing in this opinion should be interpreted as an opinion on whether *courts* possess authority to order disgorgement in SEC enforcement proceedings." 137 S. Ct. at 1642 n.3 (emphasis added). The *Commission* unquestionably has statutory authority to order disgorgement pursuant to Exchange Act Section 21B(e). 15 U.S.C. § 78u-2(e) ("In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement.").

IV. Prejudgment Interest Awards are not Punitive.

Contrary to certain Respondents' arguments, prejudgment interest awards are not punitive. *See, e.g.,* Lex Br. at 10; Mayer Br. at 18; Rabinovich Br. at 18. "[P]rejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the

equivalent of an interest free loan from the wrongdoer's victims." *Matter of Coxon*, Rel. No. 2161, 2003 WL 21991359, at *14 (Comm'n Op. Aug. 21, 2003); *see also SEC v. Lauer*, 478 F. Appx. 550, 557-58 (11th Cir. 2012) (affirming prejudgment interest award after lengthy litigation because "awards of prejudgment interest are compensatory, not punitive . . . [and] district court acted within its discretion in . . . disallowing [defendant] from being unjustly enriched by collecting interest on his ill-gotten gains"); *Matter of Milwaukee Cheese Wisconsin, Inc.*, 112 F.3d 845, 849 (7th Cir. 1997) (to deem prejudgment interest "punitive . . . misunderstands why courts aware prejudgment interest"). Here, Respondents have had full use of their ill-gotten gains during the pendency of this proceeding, while their customers have not. Thus, the ALJ acted within her discretion in awarding prejudgment interest and preventing Respondents from being unjustly enriched by their securities laws violations.

CONCLUSION

For the reasons set forth herein, Respondents' Petitions should be denied.

Dated: June 4, 2018
New York, NY

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to Rule 450(d) that the Division of Enforcement's Supplemental Reply Brief complies with the length limitations set forth in the Commission's Order dated May 31, 2018. The Division's Brief, exclusive of pages containing the table of contents and table of authorities, is 4,611 words.

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CERTIFICATE OF SERVICE

I hereby certify that on June 4, 2018, I filed the Division of Enforcement's Supplemental Brief with the Office of the Secretary of the Commission via facsimile at (202) 772-9324 and served copies on the following persons by UPS Next Day Air and email to:

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