UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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ADMINISTRATIVE PROCEEDING
File No. 3-15526

In the Matter of

GEORGE B. FRANZ III

and

RUBY CORPORATION

THE DIVISION OF ENFORCEMENT'S PRE-HEARING BRIEF

Robin Andrews
Jonathan S. Polish
Christopher H. White
U.S. Securities and Exchange Commission
175 West Jackson Boulevard, Suite 900
Chicago, Illinois 60604
Telephone: 312.353.7390
Facsimile: 312.353.7398
Email: andrewsr@sec.gov (Andrews)

Counsel for the Division of Enforcement

I. INTRODUCTION

This case concerns Respondent George Franz's failure to meaningfully act once he learned of his son's fraud. George Franz first learned of thefts by Andrew Franz in January 2007. From 2008 through early 2011, he learned of more fraud by Andrew. George Franz failed to take any meaningful action to stop his son's continued thefts or otherwise protect his advisory clients at Ruby Corporation ("Ruby"). He also failed to disclose Andrew's thefts to his clients. Finally, he failed to enact meaningful compliance procedures or conduct compliance reviews. By virtue of these failures to act in the face of ongoing fraud, the Respondents: (1) failed to supervise Andrew Franz; (2) violated the antifraud provisions of the Investment Advisers Act of 1940 ("Advisers Act"); and (3) violated the Advisers Act compliance rule.

But this case is not just about George Franz's <u>in</u>action. This case is also about his improper <u>actions</u> in response to his son's misconduct. He actively concealed Andrew's thefts through lies and material omissions. He impeded other Ruby personnel's attempts to investigate Andrews' conduct. After Andrew was caught and barred by FINRA and fired from Ruby, George Franz lied to his clients about Andrew's thefts. He shredded records he was required to keep that contained evidence of Andrew's thefts (and George's knowledge of those thefts). He filed a Form ADV for Ruby Corporation that falsely denied prior knowledge of Andrew's thefts. He lied to the SEC staff in three examinations of Ruby from October 2009 to August 2011, preventing earlier discovery of Andrew's fraud. He lied to the SEC staff under oath in investigative testimony. And he produced to the SEC fictitious letters to Ruby clients and then lied under oath about sending them to the clients. Through these actions, the Respondents: (1) aided and abetted Andrew's violations; (2)

violated the antifraud provisions of the Advisers Act; (3) violated the books and records provisions of the Advisers Act; and (4) violated the Form ADV provisions of the Advisers Act.

II. RESPONDENTS' VIOLATIONS

A. Background

Ruby Corporation is based in Beachwood, Ohio, an eastern suburb of Cleveland. George Franz has always been Ruby's sole owner, principal, and Chief Compliance Officer. Ruby's clients are typically middle-age and retirement-age individuals in the Cleveland, Youngstown, and Dayton, Ohio areas. Ruby's client accounts are discretionary and are invested in mutual funds and variable annuities. OIP at ¶2.

In approximately 2006, George Franz started turning over control of Ruby's operations to his son. *Id.* at ¶10. George Franz testified that he intended to transfer the business to Andrew once George retired. *Id.* From 2006 through 2011, George spent approximately four months a year in Florida, where he also had a residence. *Id.* at ¶11. During those months, Andrew was present at Ruby's offices and managed Ruby's day-to-day operations. *Id.* Even when George was in Ohio, he often worked from home, leaving Andrew to manage Ruby's day-to-day operations. *Id.*

B. Andrew Franz and Ruby Corporation violated the antifraud provisions of the Exchange Act by misappropriating funds from Ruby Clients.

Andrew Franz repeatedly stole from Ruby clients. He stole about $490,000 from approximately 50 Ruby client accounts through fraudulent advisory fee and redemption requests. OIP at ¶6. The majority of these stolen funds were initially deposited into Andrew's bank accounts; a smaller portion of the stolen funds was sent directly to Ruby's bank account. *Id.* Andrew Franz primarily committed this fraud via Ruby's quarterly advisory fee request process. *Id.* at ¶¶6-9. It is undisputed that Andrew, who is now incarcerated after pleading guilty to stealing from Ruby clients, acted with scienter.[1] The majority of Andrew's fraud has been stipulated by the parties; only a small portion of his thefts are disputed.[2] The Division will establish the additional thefts through the testimony of certain victim clients as well as the Division's summary witness, Ann Tushaus.

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit any person, in connection with the purchase or sale of any security, from employing any device, scheme, or artifice to defraud, making any untrue statements of material facts, or engaging in any act, practice, or course of business which operates as a fraud or deceit. All of these elements are satisfied here. Andrew Franz made numerous fraudulent requests for funds from client accounts. In order to pay these funds, securities were sold from the client accounts at Andrew's direction and the resulting funds were disbursed via check. *See SEC. v. Zandford*, 535 U.S. 813, 820-21 (2002).

Andrew's actions and scienter can be attributed to Ruby, because Andrew was in control of Ruby's operations and was a *de facto* manager of Ruby in his father's absence. Corporations can act only through their employees and agents. *See, e.g., Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001). Accordingly, "management's scienter may be attributed to the company for purposes of liability under the antifraud provisions." *In the Matter of Sunbeam Corp*, Exchange Act Rel. No. 34-44305 (May 15, 2001), 2001 SEC LEXIS 931.

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1 On October 23, 2013, Andrew Franz was sentenced to 57 months imprisonment and ordered to pay $357,069 in restitution for his thefts from Ruby clients.

2 Division Exhibit 294 is a summary exhibit that contains a list of alleged thefts by Andrew Franz. Pages 1-5 list these thefts in chronological order. The rightmost column indicates which thefts are stipulated or not. Approximately 85% of the thefts are stipulated by the parties.

C. <u>Ruby Corporation violated Sections 206(1) and (2) of the Advisers Act through Andrew Franz's Actions.</u>

Andrew's fraud also violated the antifraud provisions of the Advisers Act. Sections 206(1) and 206(2) of the Advisers Act make it unlawful for an investment adviser to employ any device, scheme, or artifice to defraud clients or to engage in any transaction, practice, or course of business that defrauds clients or prospective clients. Section 206 establishes a federal fiduciary standard for investment advisers, including the obligations to exercise the utmost good faith in dealing with their clients, to disclose to their clients all material facts, and to employ reasonable care to avoid misleading their clients. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180,194 (1963).

Ruby also willfully violated Sections 206(1) and 206(2) through Andrew's fraudulent actions, which he committed through his role in Ruby's quarterly advisory fee request process. Andrew fell within the definition of "associated person" under Section 202(a)(17) of the Advisers Act because he was a *de facto* employee and manager of Ruby. As noted above, Andrew acted with the necessary level of scienter. For the reasons stated above, Andrew's actions and scienter can be attributed to Ruby. Thus, Ruby also violated Sections 206(1) and 206(2).

D. <u>Respondents Failed Reasonably to Supervise Andrew Franz.</u>

As alleged throughout the OIP, from January 2007 through early 2011 George Franz and Ruby Corporation became aware of numerous instances of fraud by Andrew Franz, but failed to take any meaningful steps to prevent future violations. OIP at ¶¶13-40. In addition, the Respondents failed to enact any compliance procedures. *Id.* at ¶¶37-40. From at least 2006 through 2011, George had sole supervisory responsibility over Andrew as an associated person of Ruby.[3] *Id.* at ¶12. Perhaps initially George was blinded by his love for his son. But as the overwhelming evidence of Andrew's misdeeds continued to mount from January 2007 through early 2011, George's failure to take steps to protect Ruby clients became commensurately less reasonable.

The Division will establish these facts primarily through Ruby's former accountant, Charles Wilkinson, and former Ruby employees Annmarie Stansfield and Catherine Mares – all of whom alerted George Franz to suspicious conduct by Andrew Franz. The Division's expert witness, David Paulukaitis, will also offer his expert opinion as to the reasonableness of Respondents' actions (and inaction).[4]

George Franz has admitted that he alone had supervisory authority over Andrew:

> Q: [Did you have] the ability to discipline [Andrew] within the confines of the business, for whatever he did wrong?
> A: I had the ability to do anything and everything I wanted, and there were no extremes to one side or the other. It was fully me, fully. I could have done A, I could have done Z or I could have done anything in between.
> Q: Including firing him?
> A: Absolutely, which I did.

Division Exhibit 234, September 11, 2011 Testimony at 184:1-10. The Commission has recognized that the "delicate fiduciary relationship" between an investment adviser and their clients imposes an obligation on the adviser to review and monitor the activities of its

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3 During the relevant time period, Andrew Franz was also a registered representative associated with a broker-dealer. The Division is not alleging that the Respondents failed reasonably to supervise Andrew Franz's activities as an associated person of the broker-dealer. The Division is only alleging that the Respondents failed reasonably to supervise Andrew Franz's activities as an associated person of the adviser, Ruby Corporation. Andrew Franz's alleged misconduct was related only to his advisory activities – primarily the quarterly advisory fee request process.

4 The Division has also submitted Mr. Paulukaitis's Expert Report dated January 17, 2014, which details his expert opinion.

personnel. *Shearson Lehman Brothers, Inc.*, Exchange Act Rel. No. 23640, Advisers Act Rel. No. 1038 (Sept. 24, 1986). Accordingly, persons in supervisory positions are subject to sanctions for failing reasonably to supervise any person subject to their supervision. *Dawson-Samberg Capital Mgmt., Inc.*, Advisers Act Rel. No. 1889 (Aug. 3, 2000), 2000 SEC LEXIS 1604. As a result of the above conduct, George Franz failed reasonably to supervise Andrew.

Further, Ruby failed to supervise Andrew – as early as January 2007 – because it lacked any supervisory procedures to prevent misconduct by employees or violations of the Advisers Act, specifically relating to the withdrawal of advisory client funds. *See* further discussion in Section IV(G) below.

E. George Franz aided and abetted and caused Andrew Franz's and Ruby Corporation's violations of the antifraud provisions of the Exchange Act and Advisers Act.

After learning of Andrew's fraud, George Franz failed to disclose the truth to Ruby's clients. Worse, George took affirmative steps to conceal Andrew's fraud, which enabled Andrew to continue stealing from Ruby clients. First, George provided Andrew with continued access to the Ruby advisory fee billing process, his primary vehicle of fraud. OIP at ¶40. Second, George Franz secretly replaced some stolen client funds – clients thus did not notice that funds had been taken. *Id.* at ¶42. In some instances, Andrew Franz even reimbursed his father for replacing stolen client funds. *Id.* at ¶ 45. Third, George Franz failed to inform Ruby clients that Andrew had been stealing – a particularly significant fact since Andrew continued to work at Ruby and have access to client accounts. *Id.* at ¶40. As a result, clients were deprived the opportunity to protect themselves from Andrew's continued thefts.

Fourth, George Franz failed to inform the securities custodians, who otherwise could have easily prevented further thefts by simply refusing to take further instruction from Andrew or by heightening review of client activity. *Id.* Fifth, George Franz took steps to obstruct attempts by Ruby personnel to investigate and uncover Andrew's thefts. Lastly, George Franz lied to the SEC during examinations in October 2009 and January 2011, preventing an immediate investigation.

To establish liability for aiding and abetting, the Division needs to establish: (1) a primary violation; (2) substantial assistance by the aider and abettor; and (3) the necessary scienter – i.e., the aider and abettor acted knowingly or recklessly. *See, e.g., Graham v. SEC,* 222 F.3d 994, 1000 (D.C. Cir. 2000); *Monetta Fin. Servs. v. SEC,* 390 F.3d 952, 957 (7th Cir. 2004). Here, Andrew and Ruby committed primary violations of the antifraud provisions of the Exchange and Advisers Acts. If George had not taken the above steps, Andrew very likely would have been caught years earlier, and clients would have avoided hundreds of thousands of dollars in losses. George aided and abetted Andrew's ongoing fraud – his actions substantially assisted Andrew's ability to continue his fraudulent scheme undiscovered.

In addition, a causing violation can be proved if: (1) a primary violation occurred; (2) there was an act or omission by a respondent that was a cause of the violation; and (3) the respondent knew or should have known that his conduct would contribute to the violation. *Rita J. McConville,* Exchange Act Rel. No. 51950 (June 30, 2005), 2005 SEC LEXIS 1538. Here, George Franz acted at least negligently, so he also caused Andrew's and Ruby's violations.

F. <u>The Respondents violated Sections 206(1) and (2) of the Advisers Act when George Franz repeatedly deceived Ruby clients.</u>

George Franz lied to and misled various Ruby clients about his son's thefts. Even after the SEC's March 2012 lawsuit against Andrew arising from his thefts, George misrepresented to some clients that Andrew only stole funds from the family trust or George himself, and that no client accounts had been affected. OIP at ¶43. He falsely told other victims that the withdrawals were nothing more than overcharges due to error. *Id.* at ¶44-45. He told clients everything but the truth: they had been victims of Andrew's fraud. *Id.* at ¶ 42.

George Franz also mischaracterized analysis performed by outside accountants – offering false comfort that Andrew's thefts were not widespread. In September 2011, Ruby engaged an accounting firm to perform an "agreed-upon procedures engagement" regarding advisory fees charged by Ruby ("the engagement"). *Id.* at ¶54. George Franz was aware that the procedures constituting this engagement would not discover most of Andrew's prior fraud. *Id.* at ¶56. Worse, he substantially misled the accounting firm itself by plying it with altered documents, and by withholding important information that would have changed their analysis and uncovered the full extent of Andrew's misconduct. *Id.* Finally, the engagement only covered an eighteen-month period, from January 1, 2010 through June 30, 2011. *Id.* at 56. As a result, the vast majority of Andrew's fraud was not identified in the engagement. *Id.*

Despite knowledge of these facts, George Franz assured Ruby clients that "an audit" had been performed of all Ruby client accounts. *Id.* at ¶57. George misled numerous Ruby clients (including victims of Andrew's fraud), that based upon the results of the "audit", they could rest assured that they had not been victims of Andrew's misconduct. *Id.* The Division will establish the above facts through the testimony of former Ruby Corporation personnel and clients, as well as the accountant who performed the "audit," Mark Schikowski.

Moreover, Respondents violated the antifraud provisions of the Advisers Act when they kept silent about Andrew's fraud. George Franz repeatedly failed to disclose Andrew's misconduct – and the fact that he was not being fired. Investment advisers owe a fiduciary duty to their clients and thus have an affirmative duty of "utmost good faith, and full and ***fair disclosure of all material facts***." *Capital Gains*, 375 U.S. at 194 (emphasis added). The Respondents' lies and silence constituted breaches of these duties. The evidence will show that George Franz deceived his clients in order to ensure a continued, steady stream of advisory fees. In short, he placed Ruby's (and his) interests above those of his clients. In so doing he breached his fiduciary duty and defrauded his clients.[5]

G. <u>George Franz and Ruby Corporation violated the recordkeeping provisions of the Advisers Act.</u>

As George Franz has admitted, in November 2011 he shredded boxes of Ruby paper records that included Ruby's records of pre-2010 requests for advisory fees from client accounts. Division Exhibit 239, George Franz June 4, 2013 Testimony, at 739-783. George admitted that he did not review the documents he shredded, and that he took no steps to ensure that he was not destroying documents required to be maintained under the recordkeeping provisions of the Advisers Act. *Id.* at 782-3. These destroyed records also contained myriad evidence related to

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5 George Franz, as principal and sole owner of Ruby, falls within the definition of investment adviser under Section 202(a)(11) of the Advisers Act because he was in the business of providing investment advice with respect to securities, for compensation. As a result, George can be directly charged with violations of Section 206(1) and (2). *See John J. Kenny and Nicholson/Kenny Capital Mgmt., Inc.*, IA Rel. No. 2128 (May 14, 2003). Because George is the sole principal of Ruby and was acting in his capacity as adviser, Ruby also violated these provisions of the Advisers Act through George's actions.

Andrew's pre-2010 thefts. The Division will establish the above facts through the testimony of former Ruby personnel and George Franz's prior testimony.

Section 204(a) of the Advisers Act and Rule 204-2 thereunder require, among other things, that an adviser maintain and preserve all books and records relating to the adviser's operations, including revenue, for a total of five years after the end of the year to which the record relates. George Franz has admitted that he was aware of these requirements under the Advisers Act. *Id.* at 729. In particular, Rule 204-2(a)(1) requires registered advisers to make and keep true, accurate and current, a journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger. Rule 204-2(a)(7) requires advisers to keep originals of all written communications received and copies of all written communications sent by such adviser relating to any receipt, disbursement or delivery of funds or securities. The documents George Franz shredded constituted records of original entry forming the basis of entries on Ruby's general ledger (Subsection 1), and communications related to Ruby's receipt of funds (Subsection 7). George thus willfully aided and abetted and caused Ruby's violations of the recordkeeping provisions of the Advisers Act.

H. George Franz and Ruby Corporation willfully failed to adopt compliance procedures and practices.

George Franz and Ruby failed to adopt written policies and procedures reasonably designed to prevent violations. They failed to do so even after learning of Andrew's thefts. At all relevant times, George Franz was the Chief Compliance Officer of Ruby. OIP at ¶37. Before August 2010, Ruby had no compliance procedures whatsoever. Starting in August 2010, Ruby enacted compliance procedures relating to trading on nonpublic information. *See* Division Exhibit

232. These were the only compliance procedures implemented by Ruby prior to Andrew's termination. Accordingly, during the relevant timeframe, Ruby had no procedures reasonably designed to prevent violations of the Advisers Act in connection with the withdrawal of advisory client funds. Moreover, there were no compliance reviews of associated persons of Ruby or of Ruby's compliance procedures until January 2012. *See* Division Exhibit 229. The Division will establish the above facts through the testimony of former Ruby Corporation personnel, George Franz's prior testimony, and the expert testimony of David Paulukaitis.

Advisers Act Rule 206(4)-7 requires that advisers adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the firm and its supervised persons. *See Compliance Programs of Investment Companies and Investment Advisers*, Advisers Act Rel. No. 2204, 68 F.R. 74714, 74715 (Dec. 24, 2003). Ruby Corporation willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to enact any compliance procedures. Because George was solely responsible for Ruby's compliance procedures, he willfully aided and abetted and caused Ruby's violations.

I. <u>George Franz and Ruby Corporation willfully filed a false and misleading Form ADV.</u>

On April 16, 2012, Ruby filed a Form ADV Part II, disclosing that Andrew Franz was a former associated person of Ruby, but was removed from the firm because he had consented to a FINRA bar based on allegations of misappropriation:

> [Andrew] Franz: (1) misappropriated funds belonging to Ruby Corporation and its clients in violation of NASD Conduct Rule 2110 and (2) forged an investor's signature and misappropriated his funds in violation of FINRA Rule 2010. ***This conduct was unknown to George B. Franz III and Ruby Corporation.***

Division Exhibit 251 at 5, 8 (emphasis added). For the reasons set forth above, this claim was false.

Section 207 of the Advisers Act prohibits any person from willfully making any untrue statement of material fact in any Form ADV with the Commission or willfully omitting any material fact required to be stated therein. Section 207 does not require a finding of scienter; it merely requires that a person act with the intent to do the act that constitutes the violation, regardless of whether he or she knew the act was a violation. *See, e.g., SEC v. Moran*, 922 F. Supp. 867, 900 (S.D.N.Y. 1996). As a result, George and Ruby willfully violated Section 207 of the Advisers Act, and George willfully aided and abetted and caused Ruby's violations.

J. George Franz acted with fraudulent intent when he took the above actions.

The evidence shows that George Franz acted with fraudulent intent when he engaged in the conduct described above. In particular, George Franz took numerous steps to prevent the discovery of Andrew's fraud, George's prior knowledge of the fraud, and George's own fraud on his clients. To this end, George Franz: (1) lied to SEC examination staff during examinations of Ruby; (2) lied to SEC enforcement staff during its investigation; and (3) provided false documents to SEC enforcement staff in response to investigative subpoenas.

1. During SEC examinations of Ruby Corporation, George Franz lied to SEC examination staff.

George Franz lied to SEC examination staff during three examinations of Ruby that occurred between October 2009 and August 2011. He lied when asked whether he was aware of any other potential violations of the federal securities laws. He repeatedly claimed that he was not aware of any. But each time he made such assurances to SEC exam staff, he had abundant knowledge of fraud by Andrew.

For example, in early August 2011, SEC examination staff conducted an examination of

Ruby in connection with Andrew's misconduct that FINRA uncovered, including his thefts from Ruby clients in 2010 and early 2011. OIP at ¶47. During this examination, the SEC interviewed George Franz. *Id.* George told SEC examination staff that he first learned of any potential misconduct by Andrew (other than thefts from the Marie Franz Trust and four forged client signatures in May 2010) in early 2011. *Id.* at ¶48. George also told SEC examination staff that once he learned of this misconduct, he immediately fired Andrew from Ruby. These were lies. *Id.*

2. George Franz lied under oath during the Division of Enforcement's investigation.

George's deception continued during the investigation that led to these proceedings. During investigative testimony before the SEC enforcement staff, he testified that he had disclosed to all known victims of Andrew's fraud the fact that Andrew had stolen money from them. *Id.* at ¶¶66-68. George further testified that he had mailed the letters referenced in the following section. *Id.* at ¶68. This testimony was false. *Id.*

3. During the Division's investigation, Respondents produced fabricated documents.

In November 2012, in response to SEC subpoenas, Respondents produced to the SEC enforcement staff letters George Franz purportedly sent to four Ruby clients. These clients were victims of thefts by Andrew Franz, whose accounts were later reimbursed by Ruby. OIP at ¶59. In these four letters George purportedly disclosed that Andrew had stolen the clients' funds, and that the funds were being repaid by Ruby. *Id.* Three of these letters referenced specific conversations that purportedly took place between George Franz and the client regarding the misconduct. *Id.* None of these clients ever received these letters, and these conversations never took place. *Id.* at ¶60.

These fabricated letters were not the only times that George Franz papered the file with unsent letters to clients to defend against claims that he lied or withheld material facts. *Id.* at ¶65. For example, in April 2011, a client complained to George that in March 2010 her account had been transferred out of an existing variable annuity without her consent, causing a $6,000 early surrender charge to the account. *Id.* at ¶61. In her complaint letter, the client told George that throughout 2010, Andrew had repeatedly lied to her about the surrender charge, falsely claiming it was a mistake that would be repaid. *Id.* In her complaint letter, the client threatened to report the matter to FINRA and the SEC if George did not reimburse her for the fraudulently induced surrender charge. *Id.* at ¶62. In his response letter to the client, George claimed that in March 2010 he had informed the client of the surrender charge, and that he had also later sent the client a letter disclosing the charge.[6] *Id.* These were both lies. *Id.* George Franz simply devised a story in which the client had been informed of the charges and fabricated a letter in furtherance of his story. *Id.* at ¶63.

In addition, in 2004 and 2005, George Franz told three potential clients that Ruby only received a fee if the clients' securities account managed by Ruby gained in value. *Id.* This was false. In fact, Ruby charged a percentage of clients' portfolio value each year regardless of whether the account gained or lost value. *Id.* The clients later discovered these undisclosed fees and complained. In response, George Franz claimed that he previously disclosed the fees, and specifically cited two letters he supposedly had written to the clients. *Id.* The clients never received those letters. *Id.*

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[6] A copy of the referenced letter was maintained in the client's files at Ruby, but was never sent to the client.

This evidence establishes that George Franz acted with fraudulent intent – not mere negligence – during his years of inaction in the face of Andrew's fraud. It also demonstrates that George's misstatements to Ruby clients were made with fraudulent intent.

III. SANCTIONS

The public interest compels the sanctioning of the Respondents for their serious misconduct. In determining whether sanctions should be imposed in the public interest, courts and the Commission consider: the egregiousness of the actions; the isolated or recurrent nature of the infractions; the degree of scienter involved; the sincerity of a respondent's assurances against future violations; a respondent's recognition of the wrongful nature of his or her conduct; and the likelihood that a respondent's occupation will present opportunities for future violations. *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (*quoting SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violations and the degree of harm to investors and the marketplace as a result of the violations. *See In the Matter of Marshall E. Melton, et al.*, Advisers Act Rel. No. 2151 (July 25, 2003). The Commission also may consider the extent to which a sanction will have a deterrent effect. *See In the Matter of Schield Management Co., et al.*, Exchange Act Rel. No. 53201 (Jan. 31, 2006), 2006 WL 23162, at *8.

The Respondents' misconduct was egregious and continuous, beginning in 2007 and continuing during the Division's investigation. Throughout this period, George Franz has steadfastly denied any wrongdoing, and has refused to acknowledge the wrongful nature of his conduct. Moreover, the remedies in this matter must meaningfully and fully address George's repeated lies to the SEC. Such remedies should serve as a deterrent to others who would consider lying and impeding an SEC inquiry.

A. Cease and Desist Orders are Appropriate

Section 21C of the Exchange Act, Section 203(k) of the Advisers Act and Section 9(f) of the Investment Company Act authorize the Court to issue cease-and-desist orders. Respondents' violations raise a sufficient risk of future violations to support the entry of such an order. *See In the Matter of KPMG Peat Marwick LLP*, Exchange Act Rel. No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1183-91 (the showing for a cease-and-desist order is "significantly less than that required for an injunction," and "absent evidence to the contrary," a single past violation may raise "a sufficient risk of future violation").

B. Orders of Disgorgement and Prejudgment Interest are Appropriate

Section 21C(e) of the Exchange Act, Section 203(k)(5) of the Advisers Act and Section 9(f)(5) of the Investment Company Act authorize the Court to require disgorgement, plus reasonable interest. The evidence shows that George Franz deceived his clients and covered up Andrew's thefts to ensure that the clients kept their business with Ruby, thus ensuring that Ruby would continue to earn advisory fees from their accounts. After George Franz learned of his son's misconduct, Ruby received hundreds of thousands of dollars in advisory fees from its clients, including those who were victims of Andrew's fraud. In short, George Franz placed Ruby's (and his) continued income above the best interests of the clients. Moreover, Ruby received hundreds of thousands of dollars from Andrew's thefts. In short, George Franz's misconduct resulted in substantial financial gains to the Respondents. In the event Respondents are found liable, these amounts should serve as the basis for calculating a disgorgement award.

To determine the appropriate amount of disgorgement, the Division need only show that the amount is a reasonable approximation of the profits from the violative conduct. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989). The burden then shifts to the respondent to show that the approximation is inaccurate. *Id.* The Division respectfully requests that the Court order the Respondents to disgorge all ill-gotten gains as a result of their conduct.

The Division has calculated two primary categories of ill-gotten gains to the Respondents. The <u>first category</u> of ill-gotten gains is the total of all client funds stolen by Andrew that were directly or indirectly transferred to Ruby's bank account. Andrew transferred these funds in order to prop up Ruby's dwindling revenue and to conceal from his father client departures from the firm. As noted above, Andrew's role in Ruby's quarterly fee request process was the primary mechanism through which he stole money. Through Andrew's actions, Ruby also violated the antifraud provisions of the Exchange Act and Advisers Act. Respondents should therefore disgorge all of these stolen funds.

The <u>second category</u> of ill-gotten gains is advisory fees received from those clients who were defrauded by George Franz. The evidence will show that by January 2010 – at the very latest – George Franz was already aware of widespread fraud and misconduct by Andrew. Permitting Andrew Franz to continue working at Ruby and to continue to have access to client accounts was highly irresponsible. Particularly given George's decision not to fire Andrew, as an investment adviser who owed his clients a fiduciary duty, George had an obligation to disclose to his clients both his discovery of Andrew's misconduct and Andrew's continued employment at Ruby. By failing to make such disclosures, George Franz violated Sections 206(1) and (2) of the Advisers Act. *Capital Gains*, 375 U.S. at 194. As a result, the Respondents should be made to disgorge subsequent advisory fees earned.[7] Although there were well over 100 clients at Ruby during the relevant period (many of whom would likely have left Ruby had they known the truth about Andrew), the Division's calculation of advisory fees to be disgorged only includes those 47 clients who were actual victims of Andrew's thefts.[8]

George Franz and Ruby Corporation should be ordered to pay any disgorgement jointly and severally. George Franz was the sole owner and principal of Ruby during the relevant time period, and he exerted full control over its operations. Because Ruby was George Franz's alter ego during the time of the fraudulent conduct, joint and several liability is appropriate. *In the Matter of Gerasimowicz et al.*, Initial Decisions Release No. 496 (July 12, 2013), 2013 SEC LEXIS 2019; *In the Matter of Leaddog Capital Markets, LLC, at al.*, Initial Decisions Release No. 468 (September 14, 2012), 2012 SEC LEXIS 2918.

C. Substantial Civil Penalties are Appropriate.

The public interest would be best served by requiring the Respondents to pay significant civil penalties for their serious and repeated misconduct. *See* Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act. In considering whether civil penalties are in the public interest, the factors to consider include: (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to

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[7] Most clients who subsequently learned the truth about the misconduct committed by Andrew and George later left Ruby. As the Court will hear from Ruby clients who testify in this matter, these clients would have left years earlier had George Franz told them the truth in the first place.

[8] Moreover, the Division is not seeking to disgorge management fees earned before 2010, despite the facts that: (1) George Franz was aware of instances of fraud by Andrew Franz which he failed to disclose to clients, thus violating Sections 206(1) and (2) of the Advisers Act by virtue of his silence in prior years as well; and (2) Respondents failed to supervise Andrew Franz as early as 2007.

other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the federal securities laws, state securities laws or self-regulatory rules, has been enjoined from violating such laws or rules, or has been convicted of violations of such laws or of any felony or misdemeanor described in Section 15(b)(4)(B) of the Exchange Act or Section 203(e)(2) of the Advisers Act; (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require. *Id.*

Applying these criteria, second-tier or third-tier civil penalties are appropriate against Respondents for each instance of violation, depending on the specific violation.[9] *See* 17 C.F.R. § 201.1003. Based on the multiple violations, the use of fraud, deceit, manipulation or a deliberate or reckless disregard of regulatory requirements, the substantial harm and risk of harm to investors, and the need to deter the Respondents (and other similarly situated individuals) from committing future violations, the Division respectfully requests that the Court impose multiple maximum second- and third-tier penalties against each of the Respondents. *See, e.g., in the Matter of Walter v. Gerasimowicz et al.,* Initial Decisions Release No. 496 (July 12, 2013), 2013 SEC LEXIS 2019 (imposing $150,000 maximum third-tier penalties for each of thirteen investors defrauded, for a

[9] Most of the violations at issue took place after March 2009 but before March 2013, so the maximum civil penalties for second and third tier violations are, respectively, $75,000 and $150,000 for George Franz. Second and third tier violations are, respectively, $325,000 and $725,000 for Ruby Corporation. However, because Ruby Corporation was merely the alter ego of George Franz, the Division only seeks maximum second and third tier violations against Respondents from the "natural person" provision of 17 C.F.R. § 201.1003. As a result, the Division only seeks maximum second- and third-tier violations of $75,000 and $150,000, respectively, for each violation by the Respondents outlined above.

total of $1,950,000); *In the Matter of Steven E. Muth et al.*, Initial Decision Release No. 262 (October 8, 2004), 2004 SEC LEXIS 2320 (imposing maximum third-tier penalties for each of fourteen violations, for a total of $2.09 million), *In the Matter of Eric J. Brown et al.*, Advisers Act Release No. 3376 (February 27, 2012), 2012 SEC LEXIS 636, *aff'd, Collins v. SEC*, 736 F.3d 521 (D.C. Cir. 2013) (imposing upon a supervisor maximum $65,000 second-tier penalties for each of five victims of his failure to supervise).

The amount of the civil penalty assessed against Respondents must be sufficient to deter them and others from engaging in the type of conduct at issue in this proceeding. As detailed above, the Respondents engaged serious misconduct, including:

(1) failing to supervise Andrew Franz even after learning of his fraud;
(2) aiding and abetting Andrew's fraud;
(3) deceiving Ruby clients about Andrew's misconduct;
(4) filing a false Form ADV in which Respondents denied being previously aware of Andrew Franz's misconduct;
(5) improperly destroying required books and records that George Franz knew contained evidence of his and his son's misconduct; and
(6) violating the Advisers Act compliance rule by failing to enact compliance procedures.

The Division seeks maximum second-tier penalties for each victim of the Respondents' failure reasonably to supervise Andrew Franz and their aiding and abetting of Andrew's misconduct. Alternatively, the Division seeks one-time maximum third-tier penalties for each of these two violations. This conduct created substantial harm and risk of harm to investors. For example, if George Franz had responded reasonably after learning that Andrew had stolen the approximately $12,500 in January 2007, he would have easily prevented Andrew's subsequent thefts from Ruby clients, which totaled nearly $490,000. If George Franz had responded reasonably after learning in May 2009 that Andrew Franz had misappropriated hundreds of thousands of dollars from the Marie Franz Trust, doing so would have prevented Andrew's subsequent thefts from Ruby clients, which totaled over $320,000.

The Division seeks maximum second-tier penalties for each instance of George Franz defrauding Ruby clients as to Andrew's misconduct. The Division does not seek third-tier penalties for these particular violations, because they did not each create substantial harm or risk of harm to investors. However, maximum second-tier penalties are appropriate given the repeated and fraudulent nature of these violations.

Finally, the Division seeks maximum second-tier penalties against the Respondents for: filing a false Form ADV; improperly destroying required books and records; and violating the Advisers Act compliance rule.

D. A Permanent Associational Bar against George Franz and Revocation of Ruby's Registration are Appropriate.

Under Section 203(f) of the Advisers Act, Section 9(b) of the Investment Company Act and Section 15(b)(6)(A) of the Exchange Act, as amended by Section 925 of the Dodd-Frank Act, the Commission may bar or suspend registered persons from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. *See In the Matter of John W. Lawton*, Advisers Act Rel. No. 3513 (December 13, 2012), 2012 WL 6208750 (collateral bars imposed pursuant to Section 925 of Dodd-Frank are not impermissibly retroactive as applied in proceedings based on pre-Dodd-Frank conduct).

Based on George Franz's willful violations, it is appropriate to impose upon him an associational bar which would preclude his continued employment in the securities industry. *See,* *e.g.*, *In re Fundamental Portfolio Advisors, Inc. et al.*, Securities Act Rel. No. 8251 (July 15, 2003), 80 SEC Docket 1851 (permanent associational bar ordered against portfolio manager who misled investors about a risky investment strategy). The Division respectfully submits that given George Franz's willingness to lie repeatedly to clients and the SEC staff, a permanent bar is appropriate.

Finally, given the egregious misconduct described above, Ruby Corporation's registration as an investment adviser with the Commission should be revoked.

IV. CONCLUSION

The Division of Enforcement respectfully requests that the Court accept the documentary and testimonial evidence presented at the hearing, find that Respondents engaged in the violations described in the Order Instituting Proceedings, and impose appropriate sanctions.

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Respectfully submitted,

Robin Andrews
Jonathan S. Polish
Christopher H. White
Attorneys for the Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Boulevard, Suite 900
Chicago, Illinois 60604
Telephone: 312.353.7390
Facsimile: 312.353.7398