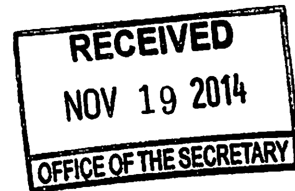
HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15617

In the Matter of **LARRY C. GROSSMAN** **and GREGORY J. ADAMS,** **Respondents.**



DIVISION OF ENFORCEMENT'S REPLY IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION AGAINST RESPONDENT GREGORY J. ADAMS

Patrick R. Costello
Senior Trial Counsel
Direct Line: (305) 982-6380
Email: costellop@sec.gov

Sunny H. Kim
Senior Counsel
Direct Line: (305) 416-6250
Email: kimsu@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. LEGAL DISCUSSION 2

A. The Division's Requested Principal Disgorgement Amount Should Not Be Reduced By Amounts Adams Claims to Have Transferred to Grossman 2

B. The Division's Requested Principal Disgorgement Amount Should Not Be Reduced By Adams' Claimed Business Expenses 3

1. Adams Failed to Plead Set-Off as an Affirmative Defense 4

2. Adams' Position With Respect To the Deduction of Business Expenses Is Incorrect 5

C. Prejudgment Interest Calculation 8

D. The Law Judge Should Reject Adams' Inability-to-Pay Defense 9

1. Adams Failed to Plead Inability-to-Pay as an Affirmative Defense 9

2. Adams Has Not Complied with the Commission's Rules of Practice in Presenting and Supporting His Inability-to-Pay Defense 9

3. Even if Adams Had Followed the Proper Predicate for Presenting an Inability-to-Pay Defense, the Circumstances of this Case Outweigh Consideration of the Defense as a Matter of Law 13

III. CONCLUSION 15

TABLE OF AUTHORITIES

CASES Page

In the Matter of Ronald S. Bloomfield et al.,
AP File No. 3-13871, 2011 SEC LEXIS 1457 (Apr. 26, 2011) 9, 14

In the Matter of Eric J. Brown et al.,
AP File No. 3-13532, 2012 SEC LEXIS 636 (Feb. 27, 2012) 13

In the Matter of Laurie Jones Canady,
AP File No. 3-8531, 1999 SEC LEXIS 669 (Apr. 5, 1999) 5

In the Matter of John A. Carley et al.,
AP File No. 3-11626, 2005 SEC LEXIS 1745 (July 18, 2005) 5

In the Matter of C.R. Williams Inc. et al.,
AP File No. 3-12834, 2008 SEC LEXIS 114 (Jan. 18, 2008) 10

In the Matter of David Henry Disraeli et al.,
AP File No. 3-12288, 2007 SEC LEXIS 3015 (Dec. 21, 2007) ...10, 11, 13

In the Matter of Walter V. Gerasimowicz et al.,
AP File No. 3-15024, 2013 SEC LEXIS 2019 (July 12, 2013) 10

In the Matter of Kevin H. Goldstein et al.,
AP File No. 3-11010, 2004 SEC LEXIS 87 (Jan. 16, 2004) 6, 11, 12

In The Matter of George J. Kolar,
AP File No. 3-9570, 1999 SEC LEXIS 2300 (Oct. 28, 1999) 4

In the Matter of L.C. Wegard & Co. et al.,
AP File No. 3-8533, 1998 SEC LEXIS 1130 (May 29, 1998) 5, 8

In The Matter of Philip A. Lehman,
AP File No. 3-11972, 2006 SEC LEXIS 659 (Mar. 20, 2006) 4

In the Matter of Philip A. Lehman,
AP File No. 3-11972, 2006 SEC LEXIS 2498 (Oct. 27, 2006) ....*passim*

In the Matter of Steven E. Muth et al.,
AP File No. 3-11346, 2005 SEC LEXIS 2488 (Oct. 3, 2005) 10

In the Matter of Richmark Capital Corp.,
AP File No. 3-9954, 2003 SEC LEXIS 2680 (Nov. 7, 2003) 5

In the Matter of M. Rimson & Co., Inc. et al.,
AP File No. 3-8772, 1997 SEC LEXIS 486 (Feb. 25, 1997) 6

In the Matter of Sky Scientific, Inc. et al.,
AP File No. 3-9201, 1999 SEC LEXIS 475 (Mar. 5, 1999) 6

In the Matter of Terry T. Steen,
AP File No. 3-8798, 1998 SEC LEXIS 1033 (June 1, 1998) 9, 10

In the Matter of Gregory O. Trautman,
AP File No. 3-12559, 2009 SEC LEXIS 4173 (Dec. 15, 2009) 11, 13

Garrison Realty, L.P. v. Fouse Architecture & Interiors, P.C.,
546 Fed. App'x 458 (5th Cir. 2013) 4

Haught v. U.S. Eng'g Contractors Corp., No. 07-cv-80436,
2009 U.S. Dist. LEXIS 2255 (S.D. Fla. Jan. 6, 2009) 4

SEC v. Aerokinetic Energy Corp., 444 F. App'x 382 (11th Cir. 2011) 2

SEC v. Banner Fund Int'l, 211 F.3d 602 (D.C. Cir. 2000) 3

SEC v. Dimensional Entm't Corp., 493 F. Supp. 1270 (S.D.N.Y. 1980) 6

SEC v. Great Lakes Equities Co. et al., 775 F. Supp. 211 (E.D. Mich. 1991)
aff'd, 12 F.3d 214 (6th Cir. 1993) 2, 3, 7, 8

SEC v. Hughes Cap. Corp., 917 F. Supp. 1080 (D.N.J. 1996)
aff'd, 124 F.3d 449 (3d Cir. 1997) 6

SEC v. JT Wallenbrock & Assocs., 440 F.3d 1109 (9th Cir. 2006) 7

SEC v. Koenig, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007)
rev'd on other grounds, 557 F.3d 736 (7th Cir. 2009) 7

SEC v. Merchant Capital, LLC, 486 F. App'x 93 (11th Cir. 2012) 6

SEC v. Pardue, 367 F. Supp. 2d 773 (E.D. Pa. 2005) 14

SEC v. Pitters, No. 09-cv-20957,
2010 U.S. Dist. LEXIS 33127 (S.D. Fla. Mar. 5, 2010) 14

SEC v. Razmilovic, 822 F. Supp. 2d 234, 277 (E.D.N.Y. 2011)
rev'd on other grounds, 738 F.3d 14 (2d Cir. 2013) 7

SEC v. U.S. Pension Trust Corp., 444 Fed. App'x 435 (11th Cir. 2011) 7

SEC v. Video Without Boundaries, Inc., No. 08-cv-61517
2010 U.S. Dist. LEXIS 141520 (S.D. Fla. Dec. 8, 2010) 7, 8

SEC v. Whittemore, 744 F. Supp. 2d 1 (D.D.C. 2010)
aff'd, 659 F.3d 1 (D.C. Cir. 2011) 2

SEC v. World Gambling, 555 F. Supp. 930, 935 (S.D.N.Y. 1983)
aff'd, 742 F.2d 1440 (2d Cir. 1983) 6

SEC v. Yun, 148 F. Supp. 2d 1287 (M.D. Fla. 2001) 14

Troxler v. Owens-Illinois, Inc., 717 F.2d 530 (11th Cir. 1983) 4

Wapato Heritage LLC v. Evans, 430 Fed App'x 557 (9th Cir. 2011) 4

FEDERAL STATUTES

Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. 523(a)(19) 15

RULES

17 C.F.R. § 201.220(c) Commission's Rules of Practice 4

17 C.F.R. § 201.630 Commission's Rules of Practice .... *passim*

17 C.F.R. § 201.630 Form D-A Commission's Rules of Practice .... *passim*

I. INTRODUCTION

The Division of Enforcement files this Reply Brief to address the arguments made by Respondent Gregory J. Adams in his Opposition to the Division's Motion for Summary Disposition. In its Motion, the Division seeks disgorgement in the principal amount of $1,070,828, plus prejudgment interest of $149,031, and a third-tier civil penalty of $1,070,828, which represents Adams' pecuniary gain as a result of the fraud at issue in this matter.

Adams makes the following arguments: (i) the Division's principal disgorgement figure should be reduced by amounts Adams claims to have transferred to the co-respondent in this matter, Larry C. Grossman; (ii) the Division's principal disgorgement figure should further be reduced by business expenses Adams claims to have incurred in operating Sovereign International Asset Management, Inc. ("Sovereign"); (iii) the Division's prejudgment interest calculation is inaccurate in light of the above-referenced deductions that Adams contends should be made to the Division's principal disgorgement figure; and (iv) Adams should not be required to pay the Division's requested civil penalty because of his current financial condition. (Opposition, at 2-8.)[1]

For the reasons set forth herein, and in the Division's Motion for Summary Disposition and accompanying Declaration of Kathleen E. Strandell, Adams' arguments should be rejected, and he should be required to pay the Division's requested disgorgement amount, prejudgment interest, and third-tier pecuniary gain civil penalty. Contrary to his characterization, these amounts are not "draconian" or "disproportional" (Opposition, at 8), but instead are equal to the kickbacks he received from Battoo's entities. Adams intentionally and flagrantly failed to disclose these kickbacks to Sovereign's investors, and he blatantly ignored numerous red flags posed by Battoo's operations in

[1] As the Division noted in its Motion for Summary Disposition, Adams is required by the Commission's April 7, 2014 Order to pay disgorgement and a third-tier civil penalty. (Motion, at 2.) The only issue in this proceeding, therefore, is the amount of disgorgement and a penalty Adams should be required to pay, as well as whether he also should pay prejudgment interest on the disgorgement amount. As noted in Section C below, however, Adams does not dispute that prejudgment interest should be imposed. Accordingly, the Law Judge may award prejudgment interest in addition to disgorgement and a third-tier civil penalty.

recommending the ill-fated investments to Sovereign clients. The only thing draconian about this case is the callous disregard for the interests of Sovereign's investors that both Adams and Grossman displayed.

II. LEGAL DISCUSSION

A. The Division's Requested Principal Disgorgement Amount Should Not Be Reduced By Amounts Adams Claims to Have Transferred to Grossman

In his Declaration submitted in connection with his Opposition, Adams claims he transferred $183,322.83 to Grossman between October 2008 and July 2010. (Adams Declaration, at ¶ 3.) He contends the same should be deducted from the Division's requested principal disgorgement amount because Adams did not retain the transferred funds. (Opposition, at 4-5.) Adams' argument is invalid, and should be rejected.

First, Adams fails to provide ***any*** explanation as to what the funds transfer was for. Assuming the transfer constitutes some kind of business expense, it cannot be deducted from the Division's requested disgorgement amount for the reasons set forth in Section B below.

And second, Adams has failed to cite a single decision where a disgorgement award was reduced by the amount of funds that one fraudster transferred to another. Quite obviously, cases hold just the opposite. For example, the court in *SEC v. Whittemore*, 744 F. Supp. 2d 1, 9 (D.D.C. 2010), *aff'd*, 659 F.3d 1 (D.C. Cir. 2011) held:

> [W]hether [defendants] chose to use this money to enhance [their] social standing through charitable contributions, to travel around the world, or to keep [their] coconspirators happy is their own business [and] . . . [w]hether [one defendant] used the proceeds to pay [the other defendants] or the grocer is irrelevant. [The defendant] was a central part of a fraud that falsely and temporarily increased the stock value of [the company] and he sold hundreds of thousands of [company] shares at inflated prices. He cannot now evade the consequences of these conceded actions.

Id. at 9; *see also SEC v. Aerokinetic Energy Corp.*, 444 F. App'x 382, 385 (11th Cir. 2011) ("[T]he cases overwhelmingly hold that '[h]ow a defendant chooses to spend his ill-gotten gains, whether it be for business expenses, personal use, or otherwise, is immaterial to disgorgement.'"); *SEC v. Great*

Lakes Equities Co. et al., 775 F. Supp. 211, 214 (E.D. Mich. 1991), *aff'd*, 12 F.3d 214 (6th Cir. 1993) ("The manner in which [the respondent] chose to spend [his] misappropriation is irrelevant" to the disgorgement analysis).

Under Adams' theory, a defendant who transfers all of the proceeds from the fraud would be exempt from disgorgement. Such an absurd result is contrary to the fundamental purposes behind disgorgement in Commission enforcement proceedings:

> [The defendant's] construction would permit the perpetrator of a successful scheme, who was just as successful at dissipating the ill-gotten gains, to avoid a disgorgement order because at the time of the order, [he] had retained none of the proceeds from the scheme. To state the proposition is to discount [the] efficacy of it.

Great Lakes, 775 F. Supp. at 214 (internal citations omitted). Indeed, if Adams' position were adopted, "a defendant who was careful to spend all the proceeds of his fraudulent scheme, while husbanding his other assets, would be immune from an order of disgorgement. [Such a proposition] would be a monstrous doctrine for it would perpetuate rather than correct an inequity." *SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000).

Accordingly, Adams' request to deduct $183,322.83 (in amounts he transferred to Grossman) from the Division's requested disgorgement amount of $1,070,828 should be denied.

B. The Division's Requested Principal Disgorgement Amount Should Not Be Reduced By Adams' Claimed Business Expenses

Adams next argues the Division's requested principal disgorgement amount should be reduced further by various business expenses he claims to have incurred in operating Sovereign. According to Adams, these expenses include: Sovereign's office rent; accounting expenses; federal and states taxes; and payroll (FICA) expenses. (Opposition, at 5.) Adams claims these expenses total $304,135.84. (Adams Declaration, at ¶ 4.)

Adams' position on this issue is directly contradicted by prior decisions of both the Commission and Law Judges. His argument therefore should be rejected.

1. Adams Failed to Plead Set-Off as an Affirmative Defense

Even assuming Adams could properly deduct business expenses from the principal disgorgement amount (which as discussed in Subsection 2 below is not the case), Adams failed to plead set-off as an affirmative defense to the Division's claims in the OIP. This is fatal to his argument.

Rule 220(c) of the Commission's Rules of Practice very clearly states that "[a] defense of res judicata, statute of limitations ***or any other matter constituting an affirmative defense*** shall be asserted in the answer." (emphasis added). Law Judges have held unequivocally that a failure to plead an affirmative defense in the answer constitutes a waiver. *See In The Matter of Philip A. Lehman*, AP File No. 3-11972, 2006 SEC LEXIS 659, at *13 (Mar. 20, 2006) (holding that because respondent failed to plead an affirmative defense, "[h]e has thus waived the issue"); *In The Matter of George J. Kolar*, AP File No. 3-9570, 1999 SEC LEXIS 2300, at *71 (Oct. 28, 1999) ("Affirmative defenses must be pled in an answer . . . or they are waived.") (internal citations omitted).

Here, Adams was represented by very experienced counsel who had the opportunity to plead set-off as an affirmative defense along with the other ***five*** affirmative defenses they interposed. And the law is clear that failure to plead set-off as an affirmative defense constitutes a waiver. *See, e.g., Garrison Realty, L.P. v. Fouse Architecture & Interiors, P.C.*, 546 Fed. App'x 458, 465 (5th Cir. 2013); *Wapato Heritage LLC v. Evans*, 430 Fed App'x 557, 559 n.2 (9th Cir. 2011); *Haught v. U.S. Eng'g Contractors Corp.*, No. 07-cv-80436, 2009 U.S. Dist. LEXIS 2255, at *4 (S.D. Fla. Jan. 6, 2009) (citing *Troxler v. Owens-Illinois, Inc.*, 717 F.2d 530, 532 (11th Cir. 1983). Indeed, the primary purpose behind the mandatory pleading requirement is to put the opposing party on notice of the defense so it has an opportunity to prepare. *See id.*

In this case, the Division has been prejudiced by Adams' failure to plead set-off as an affirmative defense. The Division had no notice the defense would be raised and thus had no

opportunity to prepare or to introduce evidence to contradict the facts Adams has offered in support. Accordingly, it is for good reason the Commission ***affirmatively requires*** respondents to plead affirmative defenses, and will find a waiver of the defenses if respondents do not include them. For that reason, the Law Judge should reject Adams' argument and find he has waived the right to claim a set-off.

2. Adams' Position With Respect To the Deduction of Business Expenses Is Incorrect

Even if Adams had properly pled set-off as an affirmative defense, his argument with respect to this issue has been flatly rejected – time and time again – by both the Commission itself and by Law Judges. The rationale behind the Commission's position is that it would be unfair and unwarranted to allow a respondent to deduct expenses and thereby receive a benefit as a result – particularly where, as here, the expenses at issue would have been incurred anyway even if there had been no fraud.

For example, in *In the Matter of Richmark Capital Corp.*, AP File No. 3-9954, 2003 SEC LEXIS 2680, at *33-34 (Nov. 7, 2003), the Commission held quite clearly that "[w]e have refused to allow such deductions in the past, and we decline to do so here . . . [as] we have previously stated, permitting such deductions would confer an unwarranted benefit on respondents." *See also In the Matter of Laurie Jones Canady*, AP File No. 3-8531, 1999 SEC LEXIS 669, at *38 (Apr. 5, 1999) (holding that respondent could not deduct from the disgorgement figure "taxes she has paid or other expenses she has incurred in connection with transactions here."); *In the Matter of L.C. Wegard & Co. et al.*, AP File No. 3-8533, 1998 SEC LEXIS 1130, at *21-22 (May 29, 1998) ("In our view, to permit such deductions would confer an unwarranted benefit on [the respondent].")

Law Judges and federal courts have followed the Commission's position and reached the same conclusion. *See, e.g.*, *In the Matter of John A. Carley et al.*, AP File No. 3-11626, 2005 SEC LEXIS 1745, at *190-92 (Init. Dec. July 18, 2005) (holding that federal and state income taxes, employee

salaries and bonuses, and payroll (FICA) taxes are not deductible from a disgorgement award); *In the Matter of Kevin H. Goldstein et al.*, AP File No. 3-11010, 2004 SEC LEXIS 87, at *54 (Init. Dec. Jan. 16, 2004) ("The Commission has not permitted the wrongdoer to reduce the amount of disgorgement to reflect taxes paid or expenses incurred."); *In the Matter of Sky Scientific, Inc. et al.*, AP File No. 3-9201, 1999 SEC LEXIS 475, at *129-30 (Init. Dec. Mar. 5, 1999) ("In calculating the disgorgement amount, the Commission is not required to take into account expenses incurred by the respondent in the course of perpetrating the scheme"); *In the Matter of M. Rimson & Co., Inc. et al.*, AP File No. 3-8772, 1997 SEC LEXIS 486, at *125 (Init. Dec. Feb. 25, 1997) ("Respondents, however, are not otherwise entitled to deduct any miscellaneous expenses such as taxes incurred or salaries paid. Such deductions would allow them to profit from their fraud."); *SEC v. Merchant Capital, LLC*, 486 F. App'x 93, 96 (11th Cir. 2012) ("[T]he overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses."); *SEC v. Hughes Cap. Corp.*, 917 F. Supp. 1080, 1087 (D.N.J. 1996), *aff'd*, 124 F.3d 449 (3d Cir. 1997) (refusing to offset disgorgement by "certain 'legitimate' business expenses," and noting that the "overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses."); *SEC v. World Gambling*, 555 F. Supp. 930, 935 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1983) (declining to reduce disgorgement amount); *SEC v. Dimensional Entm't Corp.*, 493 F. Supp. 1270 (S.D.N.Y. 1980) (holding that defendant's "expenses in carrying out his scheme and in defending himself are hardly appropriate or legitimate deductions from the amount he received for his own benefit.").

Accordingly, there is no valid legal basis on which Adams may deduct Sovereign's office rent, accounting expenses, federal and states taxes, and payroll (FICA) expenses. Assuming, however, that there were such a basis, such expenses would necessarily be limited just to those Adams incurred as a

direct result of the fraud. If he would have incurred the expenses even if there had been no fraud, the expenses would not be deductible:

> [T]here is no basis for deducting the costs of fixed expenses since those expenses would be incurred whether or not the fraud took place. By allowing a deduction for fixed expenses, part of the proceeds of the fraud is being used to defer costs that defendants [] had to pay in any event, and they would be unjustly enriched by those payments.

Great Lakes Equities, 775 F. Supp. at 215 (holding further that rent constitutes such a "fixed expense" and therefore would not be deductible). This concept is rooted in common sense. If the expenses would have been incurred even if there had been no fraud, it would confer an improper benefit on a respondent to allow him to use the ill-gotten gains to pay those expenses. Here, Adams is unable to claim a deduction for office rent or accounting because those expenses are "fixed expenses" and Sovereign would have incurred them even if Adams had never perpetrated the fraud in this case.[2] And, as noted above, income and FICA taxes are not properly deductible from a disgorgement award in any event. *See also SEC v. U.S. Pension Trust Corp.*, 444 Fed. App'x 435, 437 (11th Cir. 2011); *SEC v. Razmilovic*, 822 F. Supp. 2d 234, 277 (E.D.N.Y. 2011), *rev'd on other grounds*, 738 F.3d 14 (2d Cir. 2013); *SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007), *rev'd on other grounds*, 557 F.3d 736 (7th Cir. 2009).

The cases Adams cites in his Opposition, *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109 (9th Cir. 2006), and *SEC v. Video Without Boundaries, Inc.*, No. 08-cv-61517, 2010 U.S. Dist. LEXIS 141520 (S.D. Fla. Dec. 8, 2010), are inapposite. First, both of these cases are contrary to the wealth of decisions reached by the Commission and Law Judges above that hold – unequivocally – that expenses are not deductible from disgorgement as a matter of law. Second, in *JT Wallenbrock*, the court distinguished expenses that arise in connection with a scheme, such as broker commissions, from other expenses. Here, the expenses Adams claims to have incurred are "fixed expenses" that (i)

---

[2] Adams has not introduced any evidence in his Declaration or otherwise that would show Sovereign incurred such expenses as a direct and sole result of the fraud.

have nothing to do with Sovereign's clients (unlike the distinction drawn by the court in *JT Wallenbrock* that investors could be expected to pay a percentage of their investment toward commissions); and (ii) would have been incurred even if Adams had never perpetrated the fraud to begin with.[3] *See Great Lakes Equities*, 775 F. Supp. at 215. And third, *Video Without Boundaries* did not involve expenses the respondent sought to deduct from disgorgement. Instead, the issue there was whether ***losses*** incurred by the business could be deducted. *Video Without Boundaries*, 2010 U.S. Dist. LEXIS at *15. Here, however, Adams is not claiming any losses as part of his calculation.

As a result, Adams' request to deduct $304,135.84 in business expenses from the Division's requested disgorgement amount of $1,070,828 should be denied.

C. Prejudgment Interest Calculation

In his Opposition, Adams does not take issue with either the Division's proffered (i) prejudgment interest rate (*i.e.*, the delinquent tax rate for underpayment of federal income taxes, and assessed on a quarterly basis); or (ii) the starting and ending dates for the accrual of prejudgment interest (*i.e.*, August 31, 2010 and September 30, 2014, respectively). (Opposition, at 6.) Instead, Adams' only contention is that the requested prejudgment interest amount of $149,031 is incorrect because it is based on the principal disgorgement amount of $1,070,828 which Adams contests.

For the reasons set forth in Sections A and B above, however, the Division's requested principal disgorgement amount of $1,070,828 is proper and should not be reduced either by the amounts Adams claims to have transferred to Grossman or the business expenses Adams claims to have incurred. Accordingly, the prejudgment interest amount of $149,031 is appropriate.

---

[3] To the extent Adams is claiming Sovereign investors could be expected to shoulder some of these expenses in connection with their investment, he has failed to introduce any evidence of the same, either in his Declaration or otherwise, and the Law Judge therefore should reject such a position. *See L.C. Wegard & Co.*, 1998 SEC LEXIS at *22 (noting that respondent failed to introduce evidence of the claimed expenses).

D. The Law Judge Should Reject Adams' Inability-to-Pay Defense

As his final argument, Adams contends the Division's requested pecuniary gain civil penalty of $1,070,828 should not be imposed because his financial condition makes him unable to pay the penalty. (Opposition, at 7.) The Law Judge should reject this argument, however, and impose the full penalty because Adams has waived the defense as a matter of law and has otherwise failed to present sufficient evidence.

1. Adams Failed to Plead Inability-to-Pay as an Affirmative Defense

As with his claimed business expenses, Adams also has failed to plead inability-to-pay as a proper affirmative defense to the Commission's claims. For the reasons set forth above in Section B.1, the Law Judge therefore should reject the defense outright.

2. Adams Has Not Complied with the Commission's Rules of Practice in Presenting and Supporting His Inability-to-Pay Defense

Assuming Adams had properly pled inability to pay as an affirmative defense, he still has failed to comply with the required procedures to present the defense for consideration.

Rule 630 of the Commission's Rules of Practice addresses the very issue Adams has raised in this proceeding. The rule sets forth a detailed framework for asserting an inability-to-pay defense and the procedures a respondent must follow in order to have the defense considered. Importantly, both the Commission itself and Law Judges have specifically held that failure to adhere to the proper protocol constitutes a waiver of the defense as a matter of law and a forfeiture of the right of a respondent to argue he is financially unable to pay a civil penalty. *See, e.g.*, *In the Matter of Terry T. Steen*, AP File No. 3-8798, 1998 SEC LEXIS 1033, at *24 (June 1, 1998) ("[A] respondent who fails to introduce material evidence of inability to pay before the law judge has waived this issue."); *In the Matter of Ronald S. Bloomfield et al.*, AP File No. 3-13871, 2011 SEC LEXIS 1457, at *190-92 (Init. Dec. Apr. 26, 2011) ("By not submitting supporting information under [Rule 630], [respondents] forfeited their right to argue that they are financially unable to pay disgorgement, interest, or civil

penalties if ordered to do so."); *In the Matter of C.R. Williams Inc. et al.*, AP File No. 3-12834, 2008 SEC LEXIS 114, at *25 (Init. Dec. Jan. 18, 2008) ("[I]f a respondent raises inability to pay before a law judge but fails to introduce financial information in support of the same, in accordance with [Rule 630], respondent waives the claim of inability to pay.")[4]

The Commission has interpreted Rule 630 as affirmatively requiring a respondent who claims an inability to pay to introduce the necessary evidence and financial documentation before the Law Judge. *Steen*, 1998 SEC LEXIS 1033, at *24; *Muth*, 2005 SEC LEXIS 2488, at *77. Failure to do so constitutes a waiver of the right to present the defense as a matter of law. *Steen*, 1998 SEC LEXIS 1033, at *25; *In the Matter of David Henry Disraeli et al.*, AP File No. 3-12288, 2007 SEC LEXIS 3015, at *78 (Dec. 21, 2007); *see also In the Matter of Walter V. Gerasimowicz et al.*, AP File No. 3-15024, 2013 SEC LEXIS 2019, at *19 (Init. Dec. July 12, 2013).

Rule 630 and its companion Form D-A require, among other things, a sworn detailed account of a respondent's assets, liabilities, income and other funds received, as well as expenses incurred, from the date of the first violation through the present. *See* Rule 630(b). On the form, the respondent must schedule joint assets and income, such as those held with a spouse, and also must include supporting documentation, such as tax returns, financial statements, disbursements, and asset transfers. The detail required by the rule allows both the Division and the Law Judge to assess the whole picture of the respondent's financial circumstances, even taking into account the respondent's spending habits over the years in question.

Adams has failed to follow the proper procedure for claiming an inability to pay. He has neglected to submit the sworn financial disclosure statement and Form D-A, and has failed to include ***any*** supporting documentation, such as tax returns, with his declaration that would substantiate his

---

[4] Notably, it is Adams, not the Division, who bears the burden of proof with respect to a claim of inability to pay. *In the Matter of Philip A. Lehman*, AP File No. 3-11972, 2006 SEC LEXIS 2498, at *16 (Oct. 27, 2006); *In the Matter of Steven E. Muth et al.*, AP File No. 3-11346, 2005 SEC LEXIS 2488, at *77 (Oct. 3, 2005).

claimed financial condition. As a result, the defense should be rejected. *See In the Matter of Gregory O. Trautman*, AP File No. 3-12559, 2009 SEC LEXIS 4173, at *94 (Dec. 15, 2009) (upholding Law Judge's rejection of respondent's inability to pay defense because respondent failed to submit a sworn financial statement and supporting Form D-A); *Goldstein*, 2004 SEC LEXIS 87, at *63 (finding financial disclosure to be inaccurate and incomplete as a result of no income taxes returns or other supporting documentation).

Indeed, Adams only has asserted scant, conclusory information in his declaration describing his claimed current financial situation. Such unsubstantiated information is improper. *See*, *e.g.*, *Trautman*, 2009 SEC LEXIS 4173, at *94 (rejecting respondent's inability to pay defense because, among other things, it was "vague, incomplete, and/or unsubstantiated in a number of respects."); *Disraeli*, 2007 SEC LEXIS 3015, at *81 (rejecting defense because respondent failed to include tax returns or other documents to corroborate the information on his Form D-A, and further asserted only vague descriptions of his assets and liabilities); *Lehman*, 2006 SEC LEXIS 2498, at *21-23 (rejecting defense because respondent failed to submit evidence to support his own assertions, including real estate appraisals, mortgage information and property taxes).

Moreover, Adams has not demonstrated ***any*** evidence of his personal assets, liabilities, income or expenses from October 1, 2008 (the time he purchased Sovereign) to the present, nor has he included ***any*** financial information for his spouse. *See id.*; *see also* Form D-A at II.A ("Requests for information about you include a request for the same information about your spouse . . ."); *Lehman*, 2006 SEC LEXIS 2498, at *31 ("Disclosure of a spouse's information may be useful in determining whether, and to what extent, such spouse's assets or liabilities offset the assets and liabilities of the individual submitting the sworn financial statement."). Accordingly, neither the Division nor the Law

Judge is in a position to assess Adams' claimed circumstances, and his defense therefore must be rejected.[5]

The strictures of Rule 630 should come as no surprise to Adams. Indeed, during the telephonic prehearing conference held in this matter on March 7, 2014, Adams' counsel acknowledged the proper procedure for presenting an inability-to-pay defense, remarking that he "may be doing a hardship waiver" and that there are "situations when it's appropriate to waive, and we would like the opportunity to argue that." (March 7, 2014 Prehearing Conference Transcript, at 19:12-18; 26:13-18). And the Law Judge correctly observed during the conference that "there are forms that you have to file and tax returns that you have to produce to [the Division]." (*Id.* at 28:6-12.) Despite his counsel's representations, Adams has failed to follow the rule and the Law Judge's instructions.

Furthermore, Adams has indicated he has a part-time job and even recently established his own insurance agency. (Adams Declaration, at ¶¶ 5-6.) He also claims his family members provide him financial assistance when needed. (*Id.* ¶ 5.) In *Goldstein*, the Law Judge rejected such arguments as a basis for an inability-to-pay defense, finding that respondent was in good health and, despite his financial condition, there was "no valid reason why [he] could not work and begin to honor his financial obligations." *Goldstein*, 2004 SEC LEXIS 87, at *64. Here, unlike *Goldstein*, Adams, by his own admission, is currently employed and even has started a new business. He has not set forth any evidence that would demonstrate an ongoing inability to pay the Division's requested pecuniary gain civil penalty.

---

[5] Adams also has omitted any references to the assets he listed on his bankruptcy schedules, including, among others, the house he owns [redacted] In fact, according to the schedules, Adams claimed total assets in excess of [redacted] This is precisely why Rule 630 requires a comprehensive analysis of a respondent's financial affairs over a period of time, rather than a brief snapshot of assets at the time an inability-to-pay defense is raised.

3. Even if Adams Had Followed the Proper Predicate for Presenting an Inability-to-Pay Defense, the Circumstances of this Case Outweigh Consideration of the Defense as a Matter of Law

Even if Adams had followed the proper predicate in presenting his financial condition, the Commission has stressed that inability to pay is only "one factor that informs our determination ***and is not dispositive.***" *Trautman*, 2009 SEC LEXIS 4173, at *93 (emphasis added). Importantly, "[e]ven when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, disgorgement, or interest, particularly when the misconduct is sufficiently egregious." *Id.*; *see also In the Matter of Eric J. Brown et al.*, AP File No. 3-13532, 2012 SEC LEXIS 636, at *74 (Feb. 27, 2012); *Disraeli*, 2007 SEC LEXIS 3015, at *82; *Lehman*, 2006 SEC LEXIS 2498, at *15.

Here, Adams' misconduct was intentional, blatant, deceptive, and fraudulent. As set forth in detail in the Commission's April 7, 2014 Order, Adams acted reprehensibly in this case ***over the course of almost two years*** when he consistently: (i) failed to inform Sovereign clients their investment funds would be pooled in the name of AH Florida; (ii) recommended the Battoo Funds almost exclusively; (iii) failed to disclose to clients the fees and compensation he received from Battoo under the Referral and Consulting Agreements; (iv) as Sovereign's president and chief investment officer, disseminated the company's investment advisory agreements and prepared its Forms ADV Parts 1 and II knowing they failed to properly disclose the fees he had received from Battoo; (iv) failed to investigate numerous red flags concerning Battoo and the various investments the Battoo Funds made; (v) failed to apprise Sovereign clients of the various conflicts of interest that existed among the independent administrator and directors of the Battoo Funds; and (vi) recommended the PIWM swap to clients without fully investigating the terms of the arrangement. (April 7 Order, § III, at ¶¶ 12; 13; 21-25; 27-31; 35-39; 42-50; 52-54.) Overall, his behavior was egregious, and Sovereign's unsuspecting investors were the ultimate victims.

Aside from the misconduct Adams exhibited, the Law Judge also may take into account Adams' credibility when assessing the inability-to-pay defense. *See Bloomfield*, 2011 SEC LEXIS 1457, at *107 (finding respondent's representations concerning the inability to pay defense "suspect because he has no credibility"). At the final hearing in this matter against Grossman, Adams demonstrated a clear lack of credibility. Among other things, he repeatedly refused to acknowledge his prior investigative testimony where he specifically stated, under oath and subject to the penalties of perjury, that Grossman had "deceived" him in connection with the sale of Sovereign. (*See* Tr. Vol. II at 477:2-25, 478:1-25, 479:1-25, 480:1-25.)[6] In addition, despite claiming to be Sovereign's president and chief investment officer, Adams also could not offer ***any*** explanation as to how Grossman was able to sign Sovereign's Forms ADV Part 1 that were filed with the Commission after the company had already been sold to Adams. (*See* Tr. Vol. II at 466:8-25, 467:1-25, 468:1-8.)

In sum, the Commission itself is "cognizant of the inadvisability of assessing penalties so heavy that the persons against whom they are assessed are unable to pay them." *Lehman*, 2006 SEC LEXIS 2498, at *32. But that is precisely why the Commission enacted Rule 630 and why "adequate, credible evidence of inability to pay" is required.[7] *Id.* And where, as here, the respondent's sole evidence of an inability to pay consists of "vague [and] unsubstantiated" assertions, without complete disclosure and submission of the sworn financial statement and supporting Form D-A, the defense is properly rejected. *See id.* at *33. This is even more appropriate under the circumstances of this

---

6 The final hearing in this matter took place on March 24-26 and April 8, 2014. The transcripts for each day of the hearing are paginated consecutively in four volumes. References to the transcripts are cited above as "Tr. Vol. __ at __:__."

7 The three district court cases Adams cites in support of his defense, *SEC v. Pardue*, 367 F. Supp. 2d 773 (E.D. Pa. 2005), *SEC v. Yun*, 148 F. Supp. 2d 1287 (M.D. Fla. 2001), and *SEC v. Pitters*, No. 09-cv-20957, 2010 U.S. Dist. LEXIS 33127 (S.D. Fla. Mar. 5, 2010), each note that there are circumstances where a respondent's financial condition would excuse payment of a penalty. Because those cases are not administrative decisions, Rule 630 and the Commission's interpretation of the rule were not at issue there. Nevertheless, the Division notes that Rule 630 is consistent with the decisions in those cases, and, as discussed at length above, the Commission has developed a framework for determining when a penalty should be waived because of a respondent's financial condition. This proceeding, however, does not fit within that framework for the reasons set forth above.

proceeding, given Adams' egregious misconduct and lack of credibility, and his counsel's prior representations of intended compliance with the procedures set forth in Rule 630.

Accordingly, Adams' purported inability to pay defense should be rejected, and he should be required to pay the Division's requested pecuniary gain civil penalty of $1,070,828.[8]

III. CONCLUSION

For the foregoing reasons, and for the reasons set forth in the Division's Motion for Summary Disposition, the Division asks the Law Judge to grant its motion for summary disposition and find Adams liable for disgorgement in the principal amount of $1,070,828, prejudgment interest in the amount of $149,031, and a third-tier civil penalty in the amount of $1,070,828.

Dated: November 18, 2014

Respectfully submitted,

Patrick R. Costello
Senior Trial Counsel
Direct Line: (305) 982-6380
Email: costellop@sec.gov

Sunny H. Kim
Senior Counsel
Direct Line: (305) 416-6250
Email: kimsu@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

---

[8] Adams also calls attention to his pending Chapter 7 bankruptcy petition. (Opposition, at 7.) To the extent he contends the petition has some kind of impact on this proceeding, he is mistaken. As the Division noted in its Motion for Summary Disposition, any order for disgorgement, prejudgment interest and civil penalty the Law Judge enters in this proceeding is a non-dischargeable debt pursuant to Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. 523(a)(19). The Law Judge therefore may properly enter an order assessing those monetary amounts against Adams. To the extent Adams fails to pay the amounts, the Division will proceed in accordance with the Bankruptcy Code and Federal Rules of Bankruptcy Procedure to enforce the award.