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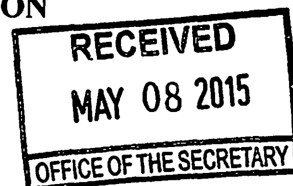
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15918

In the Matter of **DENNIS J. MALOUF,** **Respondent.**	**DIVISION OF ENFORCEMENT'S CROSS-PETITION FOR REVIEW OF INITIAL DECISION**

On April 27, 2015, Respondent Dennis Malouf filed a Petition for Review asking the Securities and Exchange Commission ("Commission") to review Administrative Law Judge Patil's April 7, 2015 Initial Decision in this matter. The Division of Enforcement ("Division") cross-petitions, under Rule of Practice 410(b), and seeks Commission review of two limited aspects of the law judge's decision: (1) the decision not to order disgorgement, despite finding that Malouf committed an ongoing fraud for over three years and, as a result, received $1,068,084; and (2) the decision to bar Malouf from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for seven-and-one-half years, under Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act").

Judge Patil correctly found that Malouf violated Sections 206(1) and 206(2) of the Advisers Act, Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934 and Rules 10b-5(a) and 10b-5(c) thereunder. Initial Decision ("ID") at 1. He also found that Malouf aided and abetted and caused violations of Sections 206(4)

and 207 of the Advisers Act and Rule 206(4)-1(a)(5) of the Advisers Act. *Id.* Judge Patil further found that Malouf's failure to seek best execution on bond trades, because he almost exclusively traded through his former broker-dealer branch in order to get paid, resulted in $265,263.60 of unnecessary cost and expense to customers of his former advisory firm, UASNM. *Id.* at 36.

I. Summary

In 2004, Malouf purchased a majority interest in UASNM and registered the firm as an investment adviser with the Commission. *Id.* at 5. At the time, Malouf was also associated as a registered representative and owned a branch of a broker-dealer at Raymond James Financial Services ("RJFS"). *Id.*

In 2007, RJFS became concerned about potential conflicts of interest and supervision risks, among other issues, arising from Malouf's work at UASNM, and asked him to choose between associating with UASNM or RJFS. *Id.* at 6. Malouf elected to continue his advisory work at UASNM and to terminate his association as a registered representative and owner of a branch office of RJFS. *Id.* Prior to RJFS approaching him, Malouf had not contemplated selling his profitable RJFS branch. *Id.* Malouf earned significant commissions from his RJFS branch prior to selling it to his friend and branch manager, Maurice Lamonde (now deceased) at the beginning of 2008. *Id.*

After selling his branch to Lamonde, Malouf continued to route UASNM client trades through his former broker-dealer branch. Malouf acknowledged that "[o]ne of the reasons Malouf chose to trade through Raymond James was because then he got paid." Stipulated FOF No. 176. While there was some dispute as to the terms of Malouf's sale of his branch to Lamonde – or

whether there was a written agreement in place in 2008 or 2009 – "Malouf agree[d] that the ongoing payment arrangement with Lamonde created a clear conflict of interest ever since he entered into the arrangement with Lamonde in early 2008." *Id.* at 13; Stipulated FOF No. 178. The law judge found that from January 2008 into 2011, "Lamonde earned $1,074,454 in commissions from RJFS on UASNM bond trades and paid $1,068,084 to Malouf." *Id.* at 9.

The law judge found that "Malouf's agreement with Lamonde created a conflict of interest for Malouf because Malouf was incentivized to send UASNM bond transactions through Branch 4GE [the RJFS branch] so that Lamonde would be able to pay what he owed for the business." *Id.* at 30. He further found that "Malouf did not explicitly and completely disclose his conflict of interest in submitting bond trades through Branch 4GE." *Id.* Malouf's failure to disclose the specifics of his agreement with Lamonde, made UASNM's "website's statements about independence and freedom from conflicts of interest, and the lack of disclosure of Malouf's continuing relationship with the RJFS branch on UASNM's Forms ADV, materially misleading to UASNM clients." *Id.*

The law judge further found "that Malouf violated his fiduciary duty by failing to seek best execution for UASNM's clients with regard to the majority of U.S. Treasury and federal agency trades routed through RJFS between 2008 and 2011." *Id.* at 32-33. Noting Malouf's own testimony that "in seeking best execution an investment adviser should shop trades to multiple brokers" and Malouf's own "admi[ssion] that he often did not do that," the law judge found that "Malouf's failure to obtain competing bids caused UASNM clients to pay markups/markdowns that were significantly higher than industry norms on dozens of U.S. Treasury and federal agency

bond trades." *Id.* at 34. Based upon the testimony of the Division's expert, Dr. Gary Gibbons, "this failure caused UASNM clients to pay between $442,106 and $693,804 in excess commissions." *Id.*

II. Malouf should be ordered to disgorge the full-amount of his fraudulent ill-gotten gains – $1,068,084.

Despite these multiple findings of fraud, and Malouf's receipt of over a million dollars in undisclosed payments under his agreement with Lamonde, the law judge did not order Malouf to disgorge the full amount of these ill-gotten gains. While acknowledging that separating legal from illegal profit is in many cases difficult and "it is therefore proper to assume that all profits gained while defendants were in violation of the law constituted ill-gotten gains" (*id.* at 43 (quoting *SEC v. Bilzerian*, 814 F. Supp. 116, 121 (D.D.C. 1993))) the law judge nonetheless found that "the monies constituting fair value for the sale of Branch 4GE are clearly identifiable as legal profits, and should not be the subject of disgorgement." *Id.* He then found that only "the monies received from excessive commissions, attributable to Malouf, should be disgorged." *Id.* This finding erroneously conditions disgorgement on investor losses, as opposed to the Respondent's ill-gotten gains.

The law judge erred in ordering Malouf to only disgorge the smallest calculable amount of excessive commissions the evidence showed that UASNM clients paid as a result of Malouf's fraud. The purpose of disgorgement is to deter violations of securities laws by depriving violators of their ill-gotten gains and to prevent unjust enrichment—that is, not allowing those who violate securities laws to gain by their illegal conduct. *SEC v. Fischbach Corp.*, 133 F.3d

170, 175 (2d 1997); *SEC v. Happ*, 295 F. Supp.2d 189, 197 (D. Mass. 2003). Unlike damages, the primary purpose of disgorgement is not to compensate investors. Accordingly, in seeking disgorgement, the Commission need not establish whether, or to what extent, identifiable private parties have been damaged by a defendant's fraud. *See SEC v. Blavin*, 760 F.2d 706, 713 (6th Cir. 1985).

The law judge calculated best execution losses, and thus disgorgement, by multiplying the low end of Dr. Gibbons' estimate of between $442,106 and $693,804 in excess commissions, by the low end of the percentage of trades directed by Malouf – 60-95% – thus arriving at $265,263.60 (60% of $442,106) "of unnecessary cost and expense to UASNM customers." ID at 36. The law judge then found that "as the Division agreed that any disgorgement awarded may be 'offset by the $506,083.74 already reimbursed to investors from [Malouf's] settlement with UASNM[,]' my order will not require Malouf to pay any additional money for disgorgement purposes." ID at 43-44.

The law judge thus improperly based disgorgement on investor losses as opposed to Malouf's ill-gotten gains. It was stipulated that Malouf was paid $1,068,084 by Lamonde and that these payments were made from commissions on trades Malouf and others made through the RJFS branch he sold to Lamonde. Stipulated FOF No. 20; No. 7. Because the law judge found that these payments were fraudulently made to Malouf they should have been considered ill-gotten gains and ordered disgorged.

By finding that "the monies constituting fair value for the sale of Branch 4GE are clearly identifiable as legal profits [that] should not be the subject of disgorgement" (ID at 43), the law

judge ignores the fact that the value of the RJFS branch Malouf sold to Lamonde derived largely from the UASNM bond trades Malouf directed through that branch. Without the fraudulent arrangement whereby Malouf generated the commissions Lamonde used to pay Malouf, the value of branch 4GE would have been a fraction of the $1.1 million Malouf claimed it was worth.[1]

The parties stipulated that from January 2008 to May 2011 UASNM traded $140,819,708.15 in bonds through RJFS. Stipulated FOF No. 23. Malouf's expert, Jerry Denigris, found that UASNM customers' bond trades incurred an average commission of 81.8 basis points. Stipulated FOF No. 23. 81.8 percent of $140,819,708.15 is $1,151,905.10. Thus UASNM accounted for 72 percent of Branch 4GE revenues over that period. *See* Div. Ex. 208 (finding that Branch 4GE had revenues of $1,603,225 from 2008 through 2010).[2] Even if Malouf's self-serving testimony that he directed only 60-70% of UASNM's bond trades is credited (*see* Tr. at 931:4-20), as it was by the law judge, Malouf's fraudulent trading still accounts for nearly half the revenues earned by Branch 4GE.

Because Branch 4GE's value was largely derived from Malouf's own fraudulent activity, the Division respectfully asks the Commission to review the law judge's finding that Malouf's estimate of its value was "clearly identifiable as legal profits" and impose full disgorgement of Malouf's $1,068,084 in ill-gotten gains.

III. The imposition of a seven-and-one-half year collateral bar is not authorized by the Advisers Act; bars under the Advisers Act are permanent.

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[1] Malouf's testified at the hearing that the branch was valued at two-times trailing revenue of $500,000 to $550,000. ID at 8.

[2] Revenues dropped off precipitously for Branch 4GE in 2011, after details of Malouf's payment agreement with Lamonde had come to light. *See* Div. Ex. 209.

The law judge ordered that as a result of Malouf's multi-year fraud, "pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act:"

> Dennis J. Malouf is barred for a period of seven-and-one-half years from [1] association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and [2] from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

ID at 47-48 (the "Bar"). In so doing, the law judge impermissibly conflated the Commission's authority under Section 203(f) to "*suspend for a period not exceeding 12 months or bar*" a person from association with any entity listed in clause [1] of the Bar, with the Commission's authority under Section 9(b) to "prohibit" a person from serving or acting in any capacity listed in clause [2] of the Bar "either permanently *or for such period of time as [the Commission] shall deem appropriate in the public interest*." *Compare* 15 U.S.C. § 80b-3(f), *with* 15 U.S.C. § 80a-9(b) (emphasis added).

Unlike Investment Company Act Section 9(b), which authorizes the Commission to impose a prohibition of *any length* on acting or serving in certain investment company-related capacities, Section 203(f) of the Advisers Act presents the Commission, and law judges acting thereunder, with only two options for removing a person from association with investment advisors and other regulated entities: (1) suspend the individual for a period not exceeding 12 months; or (2) bar the person. Section 203(f) implicitly reflects a judgment that an individual whose violation of the Advisers Act is serious enough to warrant more than a 12 month suspension from association to protect investors should be permanently barred from association. The Division respectfully asks

the Commission to review the law judge's decision to impose what amounts to a seven-and-one-half year suspension from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and instead impose a permanent bar of the same scope (whether with or without a right to reapply) against Malouf under Section 203(f) of the Advisers Act.[3]

Dated this 7th day of May, 2015.

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[3] The Division is not seeking review of the law judge's decision, pursuant to Investment Company Act Section 9(b), to bar Malouf for seven-and-one-half years from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter. (*i.e.*, clause [2] of the Bar).