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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15918

In the Matter of the Application of:

DENNIS J. MALOUF

Respondent.

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RESPONDENT'S BRIEF IN SUPPORT OF PETITION FOR REVIEW

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I. INTRODUCTION

The case against Mr. Malouf is based entirely on speculation, approximation, and the self-interested testimony of his former business partners. After years of running a successful business together, things turned sour and, in retribution for personal decisions he made that were completely unrelated to the business, Mr. Malouf was forced out of his own company, forced to forgo the amounts paid for that company, and sacrificed to the regulators.

The version of events offered by his former partners, which was adopted in the Initial Decision, requires one to accept several mutually exclusive combinations of facts:

- Mr. Kopczynski, the CCO, was responsible for the contents of Form ADV; yet, the ALJ held Mr. Malouf responsible for omissions in that document.
- Mr. Kopczynski was responsible for the contents of the firm's website; yet, Mr. Malouf was held responsible for any errors in the website.
- Mr. Hudson signed and authorized the Forms ADV, attesting to their accuracy; yet, Mr. Malouf was held responsible if they were inaccurate.
- No evidence was presented – whatsoever – that Mr. Malouf was responsible for a single trade at issue; yet, Mr. Malouf was held responsible for 60% of them.
- Mr. Malouf should have recognized and disclosed potential conflicts; but his partners were permitted merely to cover their eyes, pretending not to see what lay so obviously before them.

The reasoning in the Initial Decision shrugs off these contradictions, deferring to prosecutorial discretion. The ALJ concluded that the SEC could charge – or not charge – whomever it liked. But, the SEC did not merely charge Mr. Malouf with sole responsibility for each of the Firm's compliance failures. It charged him for the failures *of other people.* That is,

not only was the prosecution oddly lopsided, it saddled him with responsibilities that he did not carry.

What is worse, the Initial Decision not only condoned the SEC's strange prosecutorial decision-making process, it facilely allowed the uncharged individuals to avoid responsibility simply by coyly and arbitrarily determining whether they really "knew" about certain facts or conduct. By carefully defining the scope of their supposed "knowledge" and feigning ignorance as to a myriad of evidence that was right in front of their eyes, they managed to escape any liability. This, it would seem, is good news for compliance professionals who, instead of investigating potential issues, can, instead, lazily turn a blind eye and, in so doing, absolve themselves of any resultant liability.

Contrary to the findings in the Initial Decision, Mr. Malouf intended to and reasonably believed that he had met his fiduciary obligations to his clients. The findings made against him in this action are unsupported by – and often directly contrary to – the evidence actually presented. For the reasons stated herein, Mr. Malouf respectfully requests that the Commission reverse the findings that Mr. Malouf violated the securities laws alleged herein and vacate the sanctions entered against him.

II. STATEMENT OF RELEVANT FACTS

A. Mr. Malouf

Dennis Malouf ("Mr. Malouf") first registered as a securities broker in 1983. Tr. 1008:10-25.[1] He is also registered as an investment adviser. Since joining the securities

[1] Citations to the transcript of the hearing are abbreviated "Tr.___." Citations to the ALJ's findings of fact and conclusions of law as set forth in the January 8, 2015 Order on Stipulations and Transcript Corrections are cited as "FOF___" or "COL___", respectively. Respondent's Exhibits are cited as "Resp. Ex___." The Division's Exhibits are cited as "Div. Ex.___").

industry in the early 1980s, the only disclosable events on Mr. Malouf's record are the allegations arising out of the conduct at issue herein. Tr. 1009:14-1010:8.

In 1999, Mr. Malouf became associated with Raymond James Financial Services ("RJFS") and opened Branch 4GE, an office of supervisory jurisdiction ("OSJ") of RJFS. FOF 14, 15, 293. In 2004, Mr. Malouf, along with Kirk Hudson ("Mr. Hudson"), founded UASNM, Inc. ("UASNM" or the "Firm"). FOF 2, 3, 15, 16. Mr. Malouf was named UASNM's CEO and president. FOF 286. Mr. Hudson was the Firm's CFO. Tr. 1019:16-21. Joseph Kopczynski ("Mr. Kopczynski") was the chairman of the board. FOF 16. He was also Mr. Malouf's father-in-law. *Id.*

At all times relevant, UASNM was a Commission-registered investment adviser that provided discretionary advisory services to individuals, charitable organizations and employee benefit plans. FOF 2. For several years, Mr. Malouf singlehandedly operated Branch 4GE and also worked at UASNM. FOF 3 and 4. From the time of UASNM's inception onward, Branch 4GE operated out of the same office space as UASNM. FOF 325.

In 2007, Mr. Malouf terminated his association with RJFS in order to work exclusively for UASNM. FOF 5. Thus, at the end of 2007, Mr. Malouf sold Branch 4GE to Maurice LaMonde ("Mr. LaMonde"), another RJFS registered representative working out of Branch 4GE. In connection with the sale, Mr. Malouf transferred his RJFS customers either to UASNM or to Mr. LaMonde. FOF 19, 48-2. Both Mr. Hudson and Mr. Kopczynski were aware that Mr. Malouf had sold Branch 4GE to Mr. LaMonde. FOF 34.

Even after the sale, Branch 4GE continued to sublease office space from UASNM. FOF 325.

B. Joseph Kopczynski

Beginning in the early 1980s and continuing until 2004, Mr. Kopczynski owned and operated his own investment advisory firm: UAS. In 2004, Mr. Kopczynski sold UAS to Mr. Malouf and Mr. Hudson for $2,139,000. FOF 339. The resultant entity was UASNM. FOF 339. Mr. Malouf owned 59.5% of UASNM; Mr. Hudson owned 39.5% and Mr. Kopczynski retained a 1% ownership interest. FOF 114.

In 2006, Mr. Kopczynski was appointed UASNM's Chief Compliance Officer ("CCO"). He held that position from 2004 until January 2011. FOF 16, COL 21. As CCO, Mr. Kopczynski was responsible for all aspects of UASNM's compliance and supervision. *Id.* Most relevant here, Mr. Kopczynski was responsible for ensuring that Parts 1A and II of the Firm's Form ADV were properly maintained and disseminated. FOF 55, COL 20. It was also Mr. Kopczynski's responsibility periodically to review the Forms ADV and ensure their accuracy and completeness. *Id.;* FOF 47 and 58.

Mr. Kopczynski was likewise responsible for the contents of the Firm's website, an obligation specifically memorialized in the Firm's written compliance manuals. COL 19; Resp. Ex. 346; Tr. at 1287; 1289:6-25; and 1352-1357; Tr. 1361:5-25.

Further, Mr. Mr. Kopczynski was responsible for reviewing the Firm's trade tickets to ensure that the commissions being charged were reasonable and that the Firm's written policies on best execution were complied with by its investment advisers. COL 17; COL 21. If the procedures were not being followed, it was Mr. Kopczynski's responsibility to take or oversee corrective action, or to advise the CEO (Mr. Malouf) of what action needed to be taken. COL. 22.

Mr. Kopczynski resigned as CCO in January 2011 and Mr. Malouf assumed the role on an interim basis. FOF 16. Shortly thereafter, Mr. Malouf filed for divorce from

Mr. Kopczynski's daughter. Tr. 1012:7-9. Mr. Kopczynski urged Mr. Malouf to reconsider the divorce, or else "things would go poorly for him." Tr. 1054:1-12. Mr. Malouf refused to call off the divorce proceedings. *Id.* One week later, on May 13, 2011, Mr. Kopczynski and Mr. Hudson held a board meeting and voted to terminate Mr. Malouf. FOF 309; Tr. 1053:24-25. Mr. Malouf left the meeting to seek legal counsel and, upon his return, learned that he had been locked out of the office. FOF 309. On May 27, 2011, UASNM instituted legal proceedings in state court against Mr. Malouf to remove him from UASNM. FOF 310. Malouf settled with UASNM, Mr. Kopczynski and Mr. Hudson later that year. FOF 371. Pursuant to the terms of the settlement, Mr. Kopczynski and Mr. Hudson agreed to pay Mr. Malouf $1.1 million for his interest in the Firm. *Id.* Following that settlement, Mr. Kopczynski and Mr. Hudson brought the issues presented herein to the SEC's attention, blaming Mr. Malouf – and Mr. Malouf alone – for any wrongdoing or omissions. Resp. Ex. 332.

The SEC named only Mr. Malouf in the instant proceeding, but brought a separate action against UASNM. Neither Mr. Kopczynski nor Mr. Hudson was ever named as a respondent in any action brought by the SEC. UASNM settled the charges against it by agreeing to pay $506,083.74 to customers for allegedly excessive commissions they had been charged on prior trades. FOF 311. The Firm also agreed to pay the SEC a $100,000 fine. FOF 371. Both of these amounts – the compensation to clients and the civil penalty – were paid by UASNM using funds contractually owed to Mr. Malouf under the $1.1 million settlement. FOF 371. Mr. Malouf was not consulted about those decisions, nor did he consent to them. He has never been paid the balance owed to him by UASNM.

C. Kirk Hudson

Kirk Hudson was the Chief Financial Officer ("CFO") of UASNM at all times relevant. As CFO, Mr. Hudson was involved in several aspects of Firm management, including overseeing trading activity, and drafting and revising the Firm's Forms ADV. Tr. 90:24-25; 174:6-25 – 176:1-5; 230:6-9. Relevant here, Mr. Hudson was the individual at the Firm who signed the Forms ADV and certified that the information contained therein was true and correct. Mr. Hudson was aware of the sale of Branch 4GE to Mr. LaMonde and knew that Mr. Malouf was receiving ongoing payments from Mr. LaMonde following that sale. FOF 34, 347.

D. Adviser Compliance Associates, LLC

UASNM hired Adviser Compliance Associates ("ACA"), an outside compliance consulting firm, to provide advice and guidance on the Firm's compliance practices and procedures. FOF 139, 303. ACA assists firms, including UASNM, and provides recommendations regarding client reporting requirements. FOF 139, 140. UASNM engaged ACA between 2002 and 2011 to assist it with these functions. FOF 303. Mr. Kopczynski and Mr. Malouf relied on ACA to assist the Firm in meeting its compliance obligations. FOF 97, 99. As part of its services to UASNM, ACA provided mock SEC compliance audits and used that process to recommend potential updates and changes to UASNM's Form ADV. FOF 35, 93, 304, 346. The individual at ACA responsible for serving UASNM was Michael Ciambor ("Mr. Ciambor"). FOF 144, 392, 393. Mr. Ciambor worked primarily with Mr. Hudson and Mr. Kopczynski. Tr. 790:15-17.

As agreed, ACA conducted mock SEC inspections of UASNM by using the current document request list utilized in inspections by the SEC, and submitting additional document requests as needed. FOF 382. ACA also prepared the Firm's compliance manual, which was designed to keep ACA in compliance with SEC regulations. FOF 350. ACA's annual review

process included testing to ensure that the Firm's actual practices were consistent with the procedures set forth in its written manuals. Tr. 780:11-16.

ACA's review also included a review of best execution. FOF 96. Mr. Kopczynski, also, as stated above, was responsible for ensuring that the Firm met its best execution obligations, relied on ACA to assist him in ensuring the Firm was obtaining best execution. FOF 97. Each year, prior to 2010, ACA advised the Firm, including Mr. Malouf, that the Firm was complying with its best execution obligation. FOF 100. ACA never advised the Firm of any deficiencies. *Id.* Prior to May 2011, Mr. Kopczynski never indicated to Mr. Malouf that there may be any deficiencies as to best execution. FOF 101.

E. Trades at Issue

The trades at issue in this case are those which occurred following the sale of Branch 4GE to Mr. LaMonde. Specifically, this case turns on (1) whether the Firm principals other than Mr. Malouf (i.e., Mr. Hudson and Mr. Kopczynski) were aware that Mr. Malouf was directing trades to RJFS (through Branch 4GE) while receiving ongoing payments from Mr. LaMonde as consideration for the sale of the Branch; (2) whether Mr. Malouf believed that relationship had been disclosed to customer and prospective customers; and (3) whether UASNM's clients received best execution on their trades placed through Branch 4GE.

Prior to the sale of Branch 4GE, Mr. Malouf was an investment adviser with UASNM and a registered representative of RJFS. FOF 18, 19. UASNM (and its predecessor entity, UAS, owned by Mr. Kopczynski) placed certain securities trades through RJFS. FOF 170, 297.

After Branch 4GE was sold to Mr. LaMonde, as described above, UASNM continued placing certain securities trades through RJFS. *Id.* These trades were made by Mr. Malouf, as well as Mr. Hudson and Mr. Keller (another adviser at UASNM). FOF 297.

UASNM's process, with respect to best execution, was to utilize a three-bid process. FOF 133. Mr. Kopczynski, as CCO, was responsible for ensuring that the Firm was complying with its best execution obligations. FOF 98. ACA also reviewed the Firm's best execution practices and policies as part of its engagement. FOF 96. Each year, ACA conducted a periodic and systematic evaluation of the execution quality of UASNM's client trades in equities and fixed income. FOF 96, 99, 100. Mr. Kopczynski sent the Firm's monthly trade blotters to ACA on a quarterly basis for review. Tr. 1291:3-4. ACA also reviewed the Firm's trade confirms. Tr. 1303:19-24. Mr. Ciambor reported to Mr. Kopczynski that Mr. Malouf had shown him evidence of bids received on bond transactions, as part of his review. Tr. 837:6-838:1. Further, Mr. Ciambor testified that he saw evidence during his annual mock SEC audits that UASNM was seeking best execution on fixed income investments. Tr. 726:3-13. Until June 2010, ACA informed the Firm that it was complying with its best execution obligations. FOF 100. No issues or deficiencies were identified. *Id.;* Tr. 1128. Mr. Malouf relied upon ACA and Mr. Kopczynski to assist the Firm in complying with its best execution obligations. FOF 97 and 98.

Mr. Malouf testified that before making bond trades, he utilized RJFS's BondDesk information, which compared the data of over a hundred different broker dealers and showed the five best bid/ask for a particular bond. Tr. 937:24-25 – 938:1-2; Tr. 1099:24-1102:20. BondDesk is utilized by thousands of other broker-dealers in the industry, including RJFS. FOF 201; Tr. 1099:15-17. Using BondDesk allowed Mr. Malouf to survey the broader market on the bonds and determine the most competitive prices.

Also, Mr. Malouf frequently obtained outside bids on the bond transactions and routinely reviewed the trade file, which showed past trades executed by the Firm's customers.

Tr. 1106:6-23. More often than not, the lowest bond prices achieved were those run through RJFS.[2] *Id.*

Mr. Malouf was also very familiar with RJFS and its best execution policies. Tr. 1107:21-1109:15. After he sold the RJFS branch and began placing trades through RJFS as a client, he already had a more than 10-year working relationship with that firm. FOF 293. He was aware that RJFS had a maximum retail commission grid and that it had written policies mandating that RJFS obtain the best execution for its customers. FOF 265, 266, 267; Tr. 1109:12-1110:1111:22.[3]

He also found RJFS had "spot on" research capabilities (even in a time of great market turmoil). Tr. 1091:12-1092:19. Further, Mr. Malouf believed that RJFS best served his business in that it was (1) able to handle the size of transactions he needed; (2) could do so quickly; (3) could do so at a reasonable cost; and (4) was responsive to his clients' needs. Tr. 1092:20-1094:2; Tr. 1095:21-22; Tr. 1106:24-1107:8. Mr. Malouf confirmed that RJFS prices were competitive not only by contacting other brokerage firms (as detailed above), but by checking the trade files which showed past trades executed by the Firm's customers.

F. Forms ADV

Mr. Kopczynski, UASNM's CCO, was responsible for ensuring that Parts 1A and II of Form ADV were properly maintained and disseminated. FOF 55, COL 20. In discharging that obligation, he was required to periodically review the Forms ADV and ensure their accuracy and completeness. *Id.;* FOF 47 and 58. Mr. Hudson, as CFO, oversaw the drafting and revising of

[2] Mr. Malouf's familiarity with RJFS and his reasonable belief that RJFS was achieving best exaction for his clients also undermines the ALJ's conclusion that Mr. Malouf "recklessly disregarded" his fiduciary duties, a basis for the assessment of a third-tier penalty. The Commission should reverse that finding, given Mr. Malouf's entirely reasonable and good faith belief that RJFS achieved the best execution for his clients.

[3] When UASNM bought or sold fixed income securities through RJFS, it was acting as a customer (and therefore RJFS' written procedures required that RJFS obtain best execution). FOF 269.

the Firm's Forms ADV, reviewed them for accuracy and truthfulness, signed some, and uploaded them. FOF 54; Tr. 233:12-234:12.

Prior to the sale of Branch 4GE, the Firm's Form ADV disclosed that Mr. Malouf owned Branch 4GE and that he may receive commissions on transactions that were directed there for UASNM customers. FOF 30; Resp. Ex. 399. Several Forms ADV, through December 2008, disclosed that UASNM employees were or may be registered representatives of RJFS and could receive commissions as a result of that relationship. FOF 30; Resp. Exs. 399, 401 and 403. ACA, as the Firm's compliance consultant at that time, reviewed the disclosure regarding the RJFS relationship. FOF 373.

In 2008, Mr. Malouf sold branch 4GE to Mr. LaMonde. Mr. Kopczynski, Mr. Hudson and Mr. Ciambor were all aware of the sale. FOF 34, Neither Mr. Kopczynski, Mr. Hudson, nor Mr. Ciambor requested a copy of the sales agreement. FOF 62, 103, 126. Mr. Ciambor believed that, in a real SEC exam, an SEC examiner would have requested a copy of the sales agreement and investigated further to determine if any sort of ongoing payments existed. FOF 104, 105. Mr. Ciambor, however, in conducting his mock exams, never did so, despite sending other document requests. FOF 382.

Mr. Malouf was aware of the potential conflict the sale created and believed it should be disclosed. FOF 193. He also believed, however, that it had been disclosed, and testified he had seen the disclosure in the ADV drafts Mr. Kopczynski gave him to review:

> **Q: Let's talk about the ADVs and the disclosure of the conflict of interest; okay?**
>
> A: Okay.
>
> **Q: I believe you've already testified that you acknowledge that the receipt of payments from Mr. Lamonde would constitute potential conflict of interest; right?**

A: Yes.

Q: And you felt like that should be disclosed?

A: Yes.

***

Q: Now, you testified earlier today about the number of ADVs over this three-year period -- 13 or so. Do you have a specific recollection of reviewing all 13 of those?

A: No. As a matter of fact, ***I was astonished to find out that there were 13 different ADVs that were floating around in three years.*** I mean, it seemed excessive to me. I couldn't believe what the changes were. I had no idea.

Q: Did you feel like you had to disclose that conflict of interest at any point on the ADVs?

A: I did.

Q When was that?

A: Right after ***I remember seeing language that said that I was going to receive payments over a period of time, or something like that. It just disappeared.*** And I obviously don't remember exactly when, but it was one of those 13 [drafts], I think, or 14.

Tr. 1133:12-19; Tr. 1134:11-1135:3; *See also* Tr. 998:20-23.

Later, when Mr. Kopczynski resigned as CCO, Mr. Malouf took over that position. FOF 16. At that time, Mr. Malouf reviewed the Firm's current ADV and met with ACA to go over the document to make any necessary changes. FOF 280. The Firm, like nearly every investment adviser at the time, was determining how to comply with the new ADV requirements that had just gone into effect. Resp. Ex. 584. Effective October 12, 2010, the Commission amended Form ADV and required most Commission-registered investment advisers to begin using, in early 2011, a separate client disclosure. *See* 17 CFR Parts 275 and 279, Rel. No. IA-3060. As CCO, Mr. Malouf was now responsible for the content of this new document. *Id.* The new ADV Rule would require a wholesale revision to the (then) current Form ADV,

converting the document from its former "check the box" format to an entirely narrative "brochure" format. 17 CFR Parts 275 and 279, Rel. No. IA-3060.

Mr. Malouf, now the CCO, worked with the Firm's outside compliance consultant to update and prepare the new Form ADV. (Tr. 1134:23-1137:24). During this review, Mr. Malouf learned, for the first time, that the Form no longer contained the disclosure he had seen previously, disclosing the ongoing payments from RJFS for the sale of his branch. Tr. 1134:23-1137:12. He immediately updated the Form ADV to make the disclosure. FOF 31, 280, 307; Tr. 1136:16-1137:24.

III. ARGUMENT

A. Standard Of Review

The Commission's review of the Initial Decision entered in this matter is *de novo*. *See In the Matter of Theodore W. Urban*, Rel. No. 34-63456 (Dec. 7, 2010). As such, the Commission may "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part" the findings contained therein and may "make any findings or conclusions that in its judgment are proper on the basis of the record." 17 C.F.R. § 201.411.

For the reasons stated herein, Mr. Malouf requests that the Commission reverse the erroneous findings of fact and conclusions of law contained in the Initial Decision.

B. Mr. Malouf Was Not Responsible For The Content Of The Disclosures On UASNM's Website Or Form ADV.

In order to prove its claims under Securities Act Section 17(a)(1) and (3), Exchange Act Section 10(b) and Rules 10b-5(a) and (c) and Advisers Act Sections 206(1)[4] (collectively the "Disclosure Claims"), the Division was required to establish that Mr. Malouf made a material

[4] The Initial Decision also found that Mr. Malouf aided and abetted violations under § 206(4), Rule 206(4)-1(a)(5) and Section 207. Because primary liability is unfounded, aiding and abetting liability is also necessarily unfounded as a matter of law.

misrepresentation or omission. At trial, the Division attempted to accomplish this by pointing to the disclosures made (1) in the Firm's Forms ADV, and (2) on the Firm's website, and alleging that Mr. Malouf was solely responsible for any omissions contained therein.

The Initial Decision erroneously concluded that the Division carried its burden of proof on this element, based on the reasoning that "as CEO, president, and majority shareholder of UASNM, [Mr. Malouf] had final and ultimate responsibility for UASNM's Forms ADV between 2006 and 2010." *See* Initial Decision § II.D.

Contrary to the findings contained in the Initial Decision, the evidence presented conclusively showed that (1) Mr. Kopczynski, not Mr. Malouf, was the individual responsible for ensuring that the Firm's disclosures in its Forms ADV and on its website were accurate; (2) Mr. Malouf reasonably relied on Mr. Kopczynski's ability to perform these functions; and (3) Mr. Malouf reasonably believed that Mr. Kopczynski had made the required disclosures.

Because the Division failed to carry its burden of proof on this element – vital to its claims under Securities Act Section 17(a)(1) and (3), Exchange Act Section 10(b) and Rules 10b-5(a) and (c) and Advisers Act Sections 206(1) – the conclusions to the contrary should be reversed and the sanctions and penalties assessed against Mr. Malouf for these violations vacated.[5]

1. The ALJ erroneously concluded that Mr. Malouf was responsible for the incomplete disclosures contained in the Firm's Forms ADV, despite undisputed evidence that those disclosures were Mr. Kopczynski's sole responsibility.

Despite the unambiguous finding of a delegation to Mr. Kopczynski, the Initial Decision somehow concluded that Mr. Malouf bore "final and ultimate" responsibility for the errors or

[5] *See* footnote no. 4.

omissions contained in the Firm's Forms ADV. This conclusion is clearly erroneous, is unsupported by (and contrary to) the evidence and should be reversed.

Mr. Kopczynski was the Firm's CCO from 2004 through 2010 and, as CCO, was responsible for the Firm's Forms ADV. FOF 16, COL 21. There is no dispute as to this fact. The Firm's compliance manuals expressly stated that it was Mr. Kopczynski's responsibility to ensure that Part 1A and Part II of Form ADV were properly maintained and disseminated. FOF 55, COL 20.[6] Further, it was Mr. Kopczynski's responsibility periodically to review the Forms ADV and ensure their accuracy and completeness. *Id.* As if the express text of the manuals were not enough, Mr. Kopczynski admitted the same. FOF 47 and 58.

Despite this clear, undisputed evidence, the ALJ concluded that it was Mr. Malouf, the CEO, not Mr. Kopczynski, the CCO, who bore "ultimate responsibility" for the Firm's disclosures. This conclusion runs contrary to the uncontroverted findings of fact and conclusions of law that Mr. Malouf properly delegated all responsibility for the disclosures contained in the Firm's Forms ADV to the Firm's CCO.

As a result, the Commission should reverse this conclusion and find that Mr. Malouf was not responsible for any statements or omissions contained in the Forms ADV, and dismiss the Division's Disclosure Claims.[7]

2. Mr. Kopczynski and Mr. Hudson had knowledge of the Firm's ongoing relationship with RJFS but failed to ensure it was disclosed.

The reason for the ALJ's seemingly irreconcilable conclusions – that Mr. Kopczynski was responsible for compliance but Mr. Malouf was responsible for the non-disclosure – appears to turn on whether or not Mr. Kopczynski or Mr. Hudson "knew" that Mr. Malouf had sold his

[6] *See* also Resp. Exs. 346-350.

[7] To the extent these allegations are dismissed, the aiding and abetting allegation fails as a matter of law.

RJFS branch to Mr. LaMonde. That is, if Mr. Kopczynski or Mr. Hudson knew about the sale and the fact that Mr. Malouf was continuing to receive payments from Mr. LaMonde, then Mr. Kopczynski and Mr. Hudson were charged with the responsibility to disclose any conflicts – actual or potential – arising therefrom (including in the Firm's Forms ADV and its website).

The Initial Decision concluded that these Firm Principals did not know about Mr. Malouf's agreement with Mr. LaMonde because they were unaware of the "specific terms" of the agreement. Initial Decision p. 31. This narrow analysis misses the point. The question is *not* whether Mr. Kopczynski or Mr. Hudson were provided with a copy of the agreement; nor is the question whether they knew *each and every* contractual term. Instead, the pertinent question is whether or not they knew enough to identify and disclose any potential conflicts. The evidence clearly showed they did.

It is undisputed that Mr. Kopczynski and Mr. Hudson were aware that Mr. Malouf had sold the RJFS branch office to Mr. LaMonde. FOF 34, 50. It is clear that Mr. Kopczynski and Mr. Hudson knew that Mr. Malouf had sold the RJFS branch to Mr. LaMonde pursuant to an installment agreement similar to the one Mr. Malouf had utilized years earlier (in purchasing UAS from Mr. Kopczynski himself). *Id.;* FOF 50, 51. It is clear that Mr. Kopczynski and Mr. Hudson knew that Mr. LaMonde had not yet paid in full and was making ongoing payments to Mr. Malouf. FOF 53, 59. In fact, Mr. Malouf specifically told Mr. Kopczynski that Mr. LaMonde had agreed to pay him for the branch over a period of time. Tr. 1130:6-15. It is clear that the Firm, including Mr. Malouf, continued to clear certain trades through Mr. Malouf's former RJFS branch, during the same time that Mr. Malouf was receiving payments from Mr. LaMonde. FOF 159.

Mr. Malouf, knowing that Mr. Kopczynski and Mr. Hudson were aware of his ongoing relationship with Mr. LaMonde and the RJFS branch, reasonably assumed that Mr. Kopczynski and Mr. Hudson properly considered this relationship in making the Firm's disclosures. Under these circumstances, Mr. Malouf's reliance on this accomplished team and its ability to make determinations as to the adequacy and scope of the disclosures was reasonable.

Further, even if the Commission agrees that Mr. Kopczynski and Mr. Hudson lacked specific knowledge, it is clear that they were *at least* on inquiry notice of the arrangement between Mr. Malouf and RJFS. That is, even if they did not have a copy of the agreement and even if they were not aware of the specific contractual parameters of that agreement, they had more than enough information to know that there was a potential issue in the relationship, which they were required to investigate.

They were aware:

(1) Branch 4GE was located within the same office space as UASNM;

(2) Mr. Malouf had owned the branch for years;

(3) Then, Mr. Malouf sold the branch to Mr. LaMonde;

(4) Mr. LaMonde was repaying Mr. Malouf over time;

(5) Mr. Malouf frequently asked Mr. LaMonde, in front of the whole office, when his next check would arrive;

(6) Mr. Malouf formerly processed trades through RJFS; and

(7) Mr. Malouf was continuing to process trades through RJFS.

Therefore, even were the Commission to give weight to Mr. Hudson's and Mr. Kopczynski's testimony that they did not know the *specifics* of the agreement, it cannot ignore the facts that they *did* know. Their failure to investigate and determine the nature and scope of the relationship is inexplicable and a total neglect of their responsibilities.

In fact, their conduct during the time period is so incomprehensible that it calls into question whether their testimony is reliable at all. It is far more likely that these witnesses knew all about the ongoing payments and are now simply being creative in their testimony, happy to allow Mr. Malouf to absorb the blame. Mr. Kopczynski's distaste for Mr. Malouf is obvious and originates from his daughter's failed marriage. His already-biased testimony against Mr. Malouf was suspect from the start, but his willful blindness casts even more doubt on his recollection of events.

Given these facts, the ALJ's finding that Mr. Malouf was responsible for any omission in the Forms ADV should be reversed.

3. Mr. Malouf also relied upon the expertise of his outside compliance consultant.

As demonstrated above, Mr. Malouf had every reason to believe that Mr. Kopczynski was properly executing his duties as CCO. In addition, however, Mr. Malouf was also aware that the Firm had employed a reputable outside compliance consulting firm – ACA – to assist in the drafting of its Forms ADV. Each year from 2008 to May 2011, ACA performed an on-site exam of UASNM and used that process to recommend potential updates or changes to UASNM's Form ADV. FOF 32, 36. The ALJ found ACA to be a "capable" firm that performed its functions properly. Mr. Ciambor testified that he met with Mr. Kopczynski and Mr. Hudson and worked with them in drafting the Form ADV. While neither Mr. Hudson nor Mr. Kopczynski disclosed to ACA that they knew Malouf was receiving payments from Mr. LaMonde, for whatever reason, there was no evidence whatsoever that Mr. Malouf was somehow aware of that omission. (FOF 385). As far as Mr. Malouf was aware, his delegates, Mr. Hudson and Mr. Kopczynski, had dutifully supplied ACA with all the information it needed to accomplish the task for which it had been retained.

In short, Mr. Malouf reasonably relied on Mr. Kopczynski, Mr. Hudson, and ACA, as well as their collective knowledge and experience, when reviewing the language contained in Form ADV. Tr. 1062:6-8.

4. Mr. Malouf reasonably believed that the conflict had been disclosed.

The Initial Decision "ultimately" found that because Mr. Malouf knew the details of his conflict of interest, his failure to disclose it was "extremely reckless." As stated above, however, Mr. Kopczynski and Mr. Hudson also knew the important aspects of the sale (including the ongoing payments), but made no disclosures regarding any conflicts the sale may have created. For that reason, the findings in the Initial Decision should be reversed.

Regardless, the Initial Decision also fails to take into consideration Mr. Malouf's reasonable belief that the disclosure had been made. As Mr. Malouf testified, repeatedly, during the time period at issue, when Mr. Kopczynski was CCO, Mr. Malouf regularly skimmed the Forms ADV, specifically including the disclosures that apply to him. Tr. 992:10-23. He further testified that he believed that the ongoing payments should have been disclosed *and* that he recalled seeing language in the Form ADV he reviewed right after the sale occurred to the effect that he would receive payments from RJFS over a period of time. Tr. 1133:20-21. Tr. 1124:20-22. Mr. Malouf continued to believe that the RJFS disclosure was contained in the Firm's Form ADV, until January 2011.[8]

5. If the Initial Decision is allowed to stand, it would create a dangerous precedent allowing compliance officers to avoid their disclosure obligations by subjectively determining what information he or she "know."

Mr. Kopczynski, for his part, disclaims any obligation as to this information by arguing that he never knew all the details regarding the sale transaction, and that he never saw the

[8] January 2011 events are discussed in Section D.3 below.

agreement. This argument is not only extremely tenuous, it creates a dangerous precedent. Surely, Mr. Kopczynski had sufficient facts to understand that a potential conflict existed. Further, he knew (and readily admitted) that actual or potential conflicts of interest need to be disclosed. His attempt to distance himself from this failure, based on the argument that he did not "know" all the specifics, establishes a troublingly subjective standard, which would allow compliance professionals to distance themselves from their disclosure obligations by splitting hairs as to what they "knew." Essentially, they would be able to avoid regulatory scrutiny for their actions simply by assuming the ostrich's pose and burying their heads in the sand.

The ALJ should have concluded that Mr. Malouf acted reasonably in relying on Mr. Kopczynski's representations that the disclosures were accurate and in compliance with applicable law. Because Mr. Malouf's delegation to Mr. Kopczynski, and his reliance on Mr. Kopczynski's abilities, were reasonable, the ALJ erred in concluding that Mr. Malouf was "ultimately responsible" for Mr. Kopczynski's failure to disclose.

The Commission should reverse this finding and enter an order that (1) Mr. Malouf reasonably relied on Mr. Kopczynski to properly perform his compliance obligations; (2) Mr. Kopczynski was responsible for the Firm's failure to properly disclose conflicts; and (3) the Division failed to prove that Mr. Malouf was responsible for any misrepresentation or omission made to Firm clients.

6. The ALJ properly concluded that Mr. Kopczynski was responsible for the content of the firm's website.

The above analysis likewise applies to any disclosure failure on the Firm's website. The ALJ properly found that Mr. Kopczynski was responsible for the content of the Firm's website. Initial Decision p. 14. This finding was consistent with the entirety of the evidence presented, namely: (1) the Firm's own compliance manuals, which expressly assigned that responsibility to

Mr. Kopczynski; Resp. Ex. 346; (2) Mr. Kopczynski's admission, under oath, that he bore that responsibility. (Tr. at 1287; 1289:6-25; and 1352-1357; Tr. 1361:5-25); and (3) Mr. Kopczynski's and Mr. Malouf's consistent testimony that Mr. Malouf had delegated responsibility for the website to Mr. Kopczynski.

The ALJ further concluded that despite being charged with the website's content, Mr. Kopczynski failed to take any action to correct misleading or potentially misleading information if contained. This included instances where the Firm's independent outside compliance consultant ACA brought such issues to his attention, such as that the website contained misleading representations (regarding the "void of conflicts of interest"). Stipulated FOF Nos. 85, 86, 87; *See also* Tr. 1362:13-1363:8. ACA raised this issue with Mr. Kopczynski on at least two occasions (during the September 2007 and December 2009 exams) and, despite these warnings, Mr. Kopczynski still failed to act. *Id.;* Tr. 1363-1369.

7. Despite finding that Mr. Malouf was NOT responsible for the website, the ALJ inexplicably concluded that Mr. Malouf was responsible for the website's violative language.

Despite concluding that Mr. Kopczynski, not Mr. Malouf, was primarily responsible for the content of the website and the accuracy of the statements made therein, the ALJ ultimately held Mr. Malouf liable for Mr. Kopczynski's errors. Initial Decision p. 31. This conclusion is factually impossible. That is, if Mr. Malouf was not responsible for the website's content or accuracy, he cannot have been liable for the *inaccuracy* of that content.

Further, the ALJ went on to find that Mr. Malouf's failure to correct the inaccurate content of the website (for which he was not responsible) amounted to reckless conduct. Initial Decision p. 32. This is false for two reasons. First, as noted above, Mr. Malouf was not responsible for the website. Only the person responsible for the website – Mr. Kopczynski –

could have recklessly – or otherwise – failed to maintain its accuracy. That person was not Mr. Malouf, so an analysis of his "intent" is irrelevant and improper.

Second, even if Mr. Malouf was found to have had some obligation to review and approve the content of the website, his failure to perform that obligation was not the result of recklessness – or, at least not *Mr. Malouf's* recklessness. The evidence showed that although Mr. Kopczynski was responsible for the website, he failed to take this obligation seriously. Not only did he invest zero time or effort into ensuring the accuracy of the site, even when issues were brought to his attention, he failed to act. FOF Nos. 85, 86, 87; Tr. 1363-1369. When ACA informed him that the language was improper, he failed to correct that language or bring it to the attention of any other officer of the Firm, including Mr. Malouf. *Id.* For the same reasons Mr. Kopczynski should have included the disclosures in the Firm's Forms ADV, he should have made those same disclosures here.[9]

Thus, even if Mr. Malouf had an obligation to review and update the website, his failure to perform that obligation was not intentional, reckless, or even negligent. Instead, he properly trusted and relied on Mr. Kopczynski to perform his corporate obligations. This reliance was reasonable, given that Mr. Kopczynski was both qualified and competent to perform the duties he had been delegated. Mr. Kopczynski's dereliction of his duties does not amount to reckless conduct on the part of Mr. Malouf.

C. <u>The Division Failed To Prove Its Best Execution Claims</u>

1. The Division failed to present any evidence that Mr. Malouf placed the trades at issue.

The finding that Mr. Malouf was responsible for the Firm's failure to achieve best execution lacks evidentiary support. The Division alleged that Mr. Malouf "failed to seek best

[9] *See* Sections B.2 and B.3, above.

execution on client bond trades by directing the *vast majority* of these trades to [RJFS] without obtaining competing bids...." Order Instituting Proceedings, Ex. 313, p. 2.

The Division was required to prove this "vast majority" allegation by a preponderance of the evidence. *Steadman v. S.E.C.* 450 U.S. 91 (1981). Incredibly, despite failing to present *any evidence whatsoever* that Mr. Malouf directed even a *single* bond trade, the Initial Decision nonetheless concluded that the Division had carried its burden on this claim.[10]

The Initial Decision recognized this defect in the Division's case, finding:

> To prove [that Mr. Malouf was responsible for more than 60% of the trades], the Division *could have inquired* of witnesses as to each trade, using all the documentary evidence available. However, such evidence was not presented by the Division.

Initial Decision p. 36.

This finding should have been fatal to the best execution allegations. *Steadman,* 450 U.S. 91. That is, because the Division failed to present this evidence – for whatever reason – it necessarily failed to carry its burden of proof, and the allegation should have been dismissed.[11] Conflicting speculation is not evidence. Failure to present evidence to support an essential element should result in dismissal, not in a finding of liability.

Accordingly, because of this failure, the Division's best execution allegations should have been denied outright. The Commission should reverse the findings in the Initial Decision to correct this error.

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[10] "As noted, there has been no reliable evidence showing that Malouf directed any particular trade." Initial Decision p. 35.

[11] Instead of denying the allegation due to this failure of proof by the Division, as it should have, the ALJ backed his way into a finding that Mr. Malouf must have directed approximately 60% of the trades despite there being zero evidentiary support for this percentage. He reached this number arbitrarily by first rejecting Mr. Hudson's broad estimate on the topic - in which he gave himself 35% margin of error - as likely exaggerated, self-interested, and mathematically inaccurate, only then to settle not far from the median of Mr. Hudson's range.

2. Even if the evidence supported a conclusion that Mr. Malouf was responsible for a specific percentage of the firm's trades, the division failed to show that Mr. Malouf's trades were the ones that carried the higher commissions.

Even had the Division presented evidence showing that Mr. Malouf was responsible for a certain percentage of the Firm's trades (which it did not), it likewise failed to show that Mr. Malouf's trades were the particular ones that carried the higher commissions (and thus failed to achieve best execution). The Division's expert, Dr. Gibbons, analyzed 81 bond trades (which he blithely attributed to Mr. Malouf, without support). Of those 81 trades, 31 had commissions below 70 basis points (i.e., even Dr. Gibbons would consider them reasonable). *See* Gibbons Report Figure A5-11. Thus, only 24% of the trades analyzed had commission exceeding 100 bps (the highest allowed by Mr. Malouf). FOF 43.

It is undisputed that Mr. Malouf and Mr. LaMonde had an agreement that Mr. Malouf's trades would never be charged a commission higher than 100 bps. Thus, it is logical and more likely than not that the trades that exceeded 100 bps were *not* Mr. Malouf's trades at all, but, rather, were attributable to Mr. Hudson or Mr. Keller. Even giving the Division the benefit of the doubt, it is at least *equally* likely that those trades were Mr. Hudson's or Mr. Keller's, rather than Mr. Malouf's. Establishing equal likelihood, however, does not satisfy the Division's burden of proof in this case, which requires it to have proved it is *more* likely than not that Mr. Malouf charged the "excessive" amounts. *S.E.C. v. AMX Intern Inc.*, 872 F. Supp. 1541, 1543 (1994).

Because the Division has failed to carry this burden, the claims should have been denied. The Commission should reverse the findings contained in the Initial Decision and dismiss the best execution allegations made against Mr. Malouf.

3. The calculations used in the Initial Decision were faulty.

In addition to the total lack of evidence as to Mr. Malouf's conduct, there is significant uncertainty surrounding the purported "excessiveness" of the commissions charged on those trades. The Initial Decision found that Mr. Malouf's "failure to seek best execution" resulted in an actual cost to UASNM customers of "at least $442,106." This "actual cost" was predicated entirely on the "acceptable [commission] range" set forth by the Division's expert (comparing Mr. Malouf's commissions to the "acceptable range" on which Dr. Gibbons opined).

The Initial Decision's reliance on this "acceptable range"[12] is improper for many reasons, but two stand above all others. First, Dr. Gibbons' "acceptable range" notion should be rejected because it does not derive from any ascertainable or identifiable authority published or endorsed by the Commission or any other securities regulator. He offered it solely as his own opinion without citation to or reliance upon any law, statute or published guidance by any securities regulator. The obvious impropriety of adopting such an "acceptable range," unrooted in regulatory authority, is that it sets an impossible standard for regulated fiduciaries. Effectively, Mr. Malouf has been held to a standard that did not exist at the time he was executing the transactions at issue. Even had he analyzed each and every law, statute and regulation in existence at the time, he would not have found – anywhere – any official authority setting forth the "acceptable range" promulgated for the first time by Dr. Gibbons at the evidentiary hearing. FOF 378.

To hold Mr. Malouf to a standard that is devoid of legal support and which was only conceived years after the transactions at issue actually occurred is not only meritless, it is logically irreconcilable and exceedingly unfair. The findings based on this unsupported standard should be reversed by the Commission.

[12] 0.1% to .75%. Tr. 525-526 and 555.

Second, even if the Commission is willing to entertain the concept that an acceptable range could exist, that range would have to be created by weighing *all* of the relevant factors that go into determining the reasonableness of a commission, not merely the amount charged. The Commission identified the relevant factors in its *Interpretive Release Concerning the Scope of Section 28(e) of the Securities and Exchange Act of 1934,* Exch. Act. Rel. No. 23,170 (Apr. 23. 1986), which stated:

> Best Execution Obligations
>
> [A]s a fiduciary...a money manager should consider the full range and quality of a broker's services...including, among other things, the ***value*** of research provided as well as ***execution capability***, ***commission rate***, ***financial responsibility*** and ***responsiveness***.

The only factor considered in the Initial Decision was the amount charged (or, more specifically, the amount charged compared to Dr. Gibbons' "acceptable range"). As a result, the ALJ failed to consider the evidence presented relevant to the remaining favors set forth by the Commission, including: (1) the value of research, (2) execution capability, (3) financial responsibility, and (4) responsiveness. If the entirety of the evidence had been properly considered, and properly weighed, it would have become clear that the amounts charged by the Firm were not "excessive" at all.

4. Mr. Malouf sought best prices for his customers.

Even if the Division had shown that Mr. Malouf directed the trades at issue, it still failed to prove that he did not, in fact, achieve best execution. "Best execution" is not defined in the federal securities laws, in any regulation, or in any official guidance promulgated by the Commission (or any other securities regulator). The Commission has stated that best execution involves "execut[ing] securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances." *Interpretive*

Release Concerning the Scope of Section 28(e) of the Securities and Exchange Act of 1934, Exch. Act. Rel. No. 23,170 (Apr. 23. 1986). Determining whether an investment adviser has met this standard requires an analysis of "the full range and quality of a broker's services...including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility and responsiveness...." *Id.* Best execution "is ***not*** [determined by] the lowest possible commission cost." *Id.*

The evidence showed that Mr. Malouf indeed sought best execution for his customers. In order to ensure best execution, Mr. Malouf testified that he utilized RJFS's BondDesk information, which compared the data of over a hundred different broker dealers and showed the five best bid/ask for a particular bond. Tr. 937:24-25–938:1-2; Tr. 1099:24-1102:20. BondDesk is utilized by thousands of other broker-dealers in the industry, including Raymond James. FOF 201; Tr. 1099:15-17. This allowed Mr. Malouf to survey the broader market on the bonds and determine the most competitive prices.

In addition, the evidence showed (and the Initial Decision ignored) that Mr. Malouf frequently obtained outside bids on the bond transactions. Resp. Exs. 540, 541; Tr. 1105:20-1106:5. This process was confirmed not only by Mr. Malouf, but by Mr. Keller and Mr. Hudson. Mr. Keller testified that Mr. Malouf sought bids on "every trade" they did together and that he instructed Mr. Keller that he should solicit multiple bids on his own trades.[13] Tr. 1201; FOF 316. Mr. Hudson testified that he specifically recalled discussing with Mr. Malouf's his three-bid process, as well as the fact that Mr. Malouf "checked around" for other bid prices. Tr. 263:1-12. Mr. Hudson further testified that while no documents exist

[13] And this advice was demonstrated in Keller's performance. In 2008, Keller would generally take a bond to different brokers, get bids, and choose the broker with the lowest price, just as Mr. Malouf had advised. FOF 203, 204.

reflecting this solicitation, Mr. Malouf may have sought the bids and not documented it. FOF 355.

Finally, Mr. Malouf properly relied upon RJFS, which he knew well and was intimately familiar with, to best execute his customers trades. At the time he sold the RJFS branch and began placing trades through RJFS as a client, he already had a more than 10-year working relationship with them. FOF 293. As a result, he was familiar with that firm's trading policies and procedures. Tr. 1107:21-1109:15. He was aware that RJFS had a maximum retail commission grid and written policies mandating that RJFS obtain the best execution for its customers. FOF 265, 266, 267; Tr. 1109:12-1111:22.[14]

Moreover, he was familiar with RJFS's execution practices, finding it to have "spot on" research capabilities (even in a time of great market turmoil). Tr. 1091:12-1092:19. Further, Mr. Malouf believed that RJFS best served his business, in that it was (1) able to handle the size of transactions he needed; (2) could do so quickly; (3) could do so at a reasonable cost; and (4) was responsive to his clients' needs Tr. 1092:20-1094:2; Tr. 1095:21-22; Tr. 1106:24-1107:8. Mr. Malouf confirmed that RJFS prices were competitive not only by contacting other brokerage firms (as detailed above), but by checking the trade files which showed past trades executed by the Firm's customers. More often than not, the lowest bond prices achieved, were those run through RJFS. Tr. 1106:6-23.

The evidence showed that Mr. Malouf indeed sought best execution for his customers. The ALJ ignored this evidence in determining that Mr. Malouf failed to seek best execution for this clients. These findings should be reversed and the Divisions' best execution claims denied.

[14] When UASNM bought or sold fixed income securities through RJFS, it was acting as a customer (and therefore RJFS' written procedures required RJFS obtain best execution). FOF 269.

5. There is no requirement that investment advisers solicit multiple bids prior to executing a trade; only to conduct "periodic and systematic reviews."

Despite the above evidence, the Initial Decision faulted Mr. Malouf for failing to solicit multiple bids prior to executing each and every trade. The Division failed, however, to present any authority setting forth such a standard. Not only did the Division fail to establish the existence of such a standard, the evidence presented was to the contrary. Each of the experts (including the Division's expert) agreed that there is *no obligation* that investment advisers seek multiple bids, real-time, on each trade. Tr. 548:19-22; 1404:6-24; 1406:22-25–1407:1-2.

Instead, the actual standard to which Mr. Malouf should have been held is the SEC's requirement is that firms conduct a "periodic and systematic review" of their best execution procedures. Exchange Act Rel. No. 23,170 (April 23, 1986). The evidence showed Mr. Malouf did, in fact, meet this standard. As detailed above, Mr. Malouf frequently solicited bids from other brokers. This process allowed him to ensure that the prices he was receiving from RJFS were fair market bids. He did not, however, rely solely on his own intra-firm research attempts. In order to cast the widest net, as discussed above, he utilized BondDesk, which allowed him to instantly survey the broader market on the bonds and determine the most competitive bid/ask prices. Tr. 937:24-25–938:1-2; Tr. 1099:24-1102:20.[15] Each of these practices evidences that Mr. Malouf strove to achieve best execution. Yet, Mr. Malouf went even further.

In addition to soliciting bids from other broker-dealers and utilizing BondDesk, the Firm retained ACA, an outside compliance consultant, to review its best execution policies and ensure that they were (1) compliant with the (then) current regulatory requirements and (2) being properly executed by the Firm. Mr. Ciambor confirmed during his testimony that ACA did, in

[15] BondDesk was the same bond program used by Raymond James. Tr. 1099:15-17.

fact, perform these reviews. Specifically, he conducted "periodic and systematic evaluation[s] of the execution quality of client trades, which included the Firm's bond trading. Tr. 725:9-23. Mr. Ciambor further testified that this process included a review of the Firm's written policies and trading documents as well as interviews with Firm personnel. Tr. 725:9-23; 726:3-25. Mr. Ciambor performed these functions before concluding that UASNM was following best practices for best execution. *Id.;* FOF 264. ACA never identified any issues regarding UASNM's best execution practices (FOF 100).

Each of these facts caused Mr. Malouf to conclude, reasonably, that the Firm met its best execution guidelines.

6. The 1% rule, created by the Initial Decision, is contrary to established law.

The Initial Decision created a new bright-line standard for assessing the reasonableness of commissions charged on a U.S. Treasury or agency bond. Initial Decision p. 16. Without authority or citation, the Initial Decision held that "[a] commission over one percent on a U.S. Treasury or agency bond trade of $1,000,000 is excessive." *Id.*

Not only does this bright-line standard lack any legal or precedential basis *whatsoever*, the standard is contradicted by undisputed and well-established existing authority. That authority, including guidance promulgated by the Commission itself, makes clear that there is no law, regulation, statute or other published standard establishing a "bright-line" standard of reasonableness. Instead, commissions are proper so long as they are "reasonable" and not "excessive," regardless of their percentage. *Interpretive Release Concerning the Scope of Section 28(e) of the Securities and Exchange Act of 1934,* Exch. Act. Rel. No. 23,170 (Apr. 23. 1986). Determining whether a particular commission on a particular trade is "reasonable" requires "consider[ing] the full range and quality of a broker's services...including, among other

things, the value of research provided as well as execution capability, commission rate, financial responsibility and responsiveness...". *Id.* Best execution "is ***not*** [determined by] the lowest possible commission cost." *Id.*

Moreover, there is no dispute as to the proper standard under which the commissions at issue should be viewed. The Commission's "reasonableness" approach, set forth above, was also set forth (although subsequently ignored) in conclusions of law 15 and 16:

> There are no SEC rules or regulations establishing a specific percentage or dollar value amount that would constitute an excessive markup or commission on bond trades.
>
> Whether a markup or commission on a bond trade is reasonable is fact and situation specific on a case-by-case basis, and reasonable minds can differ as to what the range of reasonable markups or commissions might be for a given situation.

Furthermore, the Division's own expert, upon whose testimony the ALJ based his finding of liability, testified that the ranges of "acceptable" commissions he proposed were not based on any authority "published by the SEC or any industry organization." FOF 80, 112, 378 and Tr. pp. 525-526 and 555. The "acceptable" range was merely his opinion.

Indeed, the only analogous published standard on "reasonableness" of commissions is found in NASD IM-2440-1 "Mark Up Policy,"[16] which set forth a *presumptively reasonable* threshold of 5%. Even the NASD (now FINRA), however, has recognized that while the 5% percentage is helpful guidance to firms, a commission below 5% is not *per se* reasonable; nor is a commission over 5% *per se* unreasonable. *Id.* Instead, as here, NASD IM-2440-1 employs a "facts-and-circumstances" test to determine reasonableness. This notice reflects the industry's resistance to (and the impracticalities associated with) establishing a strict minimum or maximum on allowable commissions.

[16] This Interpretive Memo has since been incorporated into the Supplementary Material to FINRA Rule 2121.

The Initial Decision has done what no regulator has dared to do. As such, it is improper and should be reversed.

D. The ALJ Improperly Found That Mr. Malouf Acted Recklessly.

The Division's claims under Securities Act § 17(a)(1), Exchange Act § 10(b) and Rule 10b-5, and Advisers Act § 206 (1) all require a finding that Mr. Malouf acted with scienter. The ALJ concluded that the Division satisfied this element by establishing that Mr. Malouf acted with "extreme recklessness" in failing to make the required disclosures.

For the reasons already set forth herein, and briefly summarized below, that finding should be reversed, the finding of recklessness overruled, and the Division's claims under Securities Act § 17(a)(1), Exchange Act § 10(b) and Rule 10b-5, and Advisers Act § 206 (1) should be dismissed.

1. Mr. Malouf reasonably believed that Mr. Kopczynski, who was responsible for Form ADV and its contents, had fulfilled his compliance responsibilities.

The Initial Decision based its finding of recklessness on the fact that Mr. Malouf knew about the payments he was receiving from Mr. LaMonde but failed to disclose them. Specifically, the ALJ concluded that "regardless of what Hudson, Kopczynski...or [ACA] knew, UASNM's customers were not told about Malouf's conflict of interest and, thus, Malouf was reckless in allowing material omissions on the Forms ADV and misrepresentations on the website." Initial Decision. p. 31.

As set forth fully above, however, the evidence belied any finding of reckless conduct. To the contrary, the evidence showed that (1) Mr. Malouf delegated the responsibility of ensuring that the Firm's forms ADV were accurate and complete to his experienced and qualified

CCO,[17] Mr. Kopczynski; (2) Mr. Malouf relied on Mr. Kopczynski to perform his obligations; and (3) Mr. Malouf believed that Mr. Kopczynski had followed through, and that the disclosure had been made. *See* Section B, above.

2. The evidence showed that Mr. Kopczynski and Mr. Hudson frequently ignored their obligation to ensure accurate disclosures were made.

Mr. Kopczynski's failure to ensure that a potential conflict was disclosed is consistent with his *modus operendi.* While Mr. Kopczynski was CCO of UASNM, Mr. Malouf believed him to be the most knowledgeable of the Firm's principals as to the regulatory framework applicable to UASNM. FOF 98, 102; Tr. 1018:3-16; Tr. 1062:19-1063:6. The record in this case has made clear, however, that, unbeknownst to Mr. Malouf, Mr. Kopczynski failed to take these obligations seriously and often failed to act, even where required. He testified that he spent only one hour per week handling compliance matters. Tr. 1288:14-16. Even more troubling, the evidence showed that when issues were brought to his attention, he failed to act. For example, with regard to the statements contained on the Firm's website, when ACA informed him that the language was improper, he failed to correct the language or bring it to the attention of any other officer of the Firm, including Mr. Malouf. FOF Nos. 85, 86, 87; Tr. 1363-1369. The same was true for Mr. Hudson. Mr. Hudson testified that he believed Branch 4GE's sublease arrangement with UASNM created a potential conflict of interest, which needed to be disclosed. FOF 106. Despite identifying this conflict, he never made this disclosure nor caused the Firm to make the disclosure – ever. FOF 107.

This blatant failure to act evidences Mr. Hudson's and Mr. Kopczynski's (the principals in charge of Form ADV the Firm's disclosure compliance) intentional disregard for the Firm's

[17] Prior to becoming the CCO of UASNM, Mr. Kopczynski had been the CCO of UAS since its inception in 1990. Tr. 1391:7-13.

disclosure obligations. Their total nonchalance when it came to disclosing conflicts must be compared to the conduct of Mr. Malouf, described below, which clearly indicates a sincere desire on his part to comply and ensure that required changes were made as soon as possible.[18]

3. Upon realizing that Mr. Kopczynski had failed to make the disclosure, Mr. Malouf amended Form ADV to include it.

In January 2011, Mr. Kopczynski resigned as CCO and Mr. Malouf took over that position. FOF 16. At that time, he reviewed the Firm's current Form ADV and met with ACA to go over the document to make any necessary changes. The Firm, like nearly every investment adviser at the time, was determining how to comply with the new ADV requirements that had just gone into effect. Effective October 12, 2010, the Commission amended Form ADV and required most Commission-registered investment advisers to begin using, in early 2011, a separate client disclosure. 17 CFR Parts 275 and 279, Rel. No. IA-3060. As CCO, Mr. Malouf was now responsible for the content of this new document. The new ADV Rule would require a wholesale revision to the (then) current Form ADV, converting the document from its former "check the box" format to an entirely narrative "brochure" format. *Id.*

Mr. Malouf, now the CCO, worked with the Firm's outside compliance consultant to update and prepare the new Form ADV. Tr. 1134:23-1137:24. In so doing, Mr. Malouf learned, for the first time, that the Form no longer contained the disclosure he had seen previously, disclosing the ongoing payments from RJFS. Tr. 1134:23-1137:12. He immediately updated the Form ADV to make the disclosure. FOF 31, 280, 307; Tr. 1136:16-1137:24.

Additionally, it is important to note that in addition to making the above disclosure, Mr. Malouf presented evidence at the hearing of other instances in which he made or corrected one of the Firm's disclosure items. For example, Mr. Malouf discovered that the Form ADV

[18] *See also* Section B.2, above, discussing that Mr. Hudson and Mr. Kopczynski were *at least* on inquiry notice of Mr. Malouf's agreement with Mr. LaMonde and failed to act.

contained inaccurate information about his college degree. FOF 83. He brought that error to the Firm's attention and made sure that the disclosure was updated, to contain accurate information. *Id.*

The reasoning in the Initial Decision, finding Mr. Malouf extremely reckless for allowing the non-disclosure to continue, fails to account for this important fact. Mr. Malouf's correction of the Form ADV upon discovering its omission undermines any finding of recklessness or indifference. Accordingly, the finding of recklessness should be reversed.

4. Mr. Malouf reasonably relied on the Firm's outside compliance consultants.

The conclusion that Mr. Malouf acted recklessly is also contradicted by the evidence presented that throughout the time period at issue here, UASNM retained and utilized the services of an independent, outside compliance consultant, ACA, as discussed in Section II.B.3, above.

5. The record reflects Mr. Malouf's commitment to disclosure and compliance.

After Mr. Malouf became CCO, he discovered a number of errors, omissions, and unenforced policies that Mr. Kopczynski left behind. In addition to making the disclosure that Mr. Kopczynski had failed to make, discussed above, Mr. Malouf made several changes to the Firm's practices in order to remedy Mr. Kopczynski's mistakes and ensure the Firm's procedures were being followed. This included:

> (1) discovering that Firm representatives were using personal email to communicate with clients and reminding them that such conduct was forbidden;
>
> (2) reminding representatives that their outside business activities required Firm approval;
>
> (3) reminding representatives that client correspondence must be reviewed;

(4) circulating important rule changes and guidance;

(5) requiring weekly transaction ledger reviews;

(6) ensuring that verbal and written complaints were sent to the CCO, per the Firm's policies;

(7) reminding representatives that brokerage accounts held at other firms required approval; and

(8) mandating prior approval of political contributions.

Resp. Ex. 584; Tr. 1068:17-1082:9. This conduct cannot be squared with the finding that Mr. Malouf was "extremely reckless" or otherwise not intent on ensuring that he and the Firm was in compliance with all rules and regulations.

E. Sanctions Excessive and Not Justified

1. The sanctions are based on an improper finding of willfulness.

The ALJ's award of sanctions was based on the conclusion that Mr. Malouf's conduct was "willful." Specifically, the ALJ concluded that "Malouf's actions were unquestionably willful because he did not adequately and fully disclose his conflict of interest to UASNM and its clients and he was responsible for the false and misleading statements that appeared on UASNM's Forms ADV." Initial Decision pp. 38-39. As a result of this finding, the ALJ awarded monetary sanctions, a cease and desist order, and a collateral and associational bar against Mr. Malouf.

The ALJ based this conclusion on the reasoning that "[a] finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law." *Citing Wonsover v. SEC,* 205 F. 3d 408, 414 (D.C. Cir. 2000).

This authority, cited by the ALJ, undermines – rather than supports – a finding of willfulness. As discussed in Section B, above (1) Mr. Malouf was *not* the individual responsible for Forms ADV; (2) Mr. Malouf reasonably believed that the individual responsible for Form

ADV (Mr. Kopczynski) was properly executing his compliance duties; and (3) Mr. Malouf reasonably believed that the disclosure had been made.

As a result, Mr. Malouf did not "willfully" fail to make the disclosures regarding the RJFS branch and the ALJ's finding of willfulness was erroneous and should be reversed. Additionally, each of the sanctions founded on a finding of willfulness should be denied, including monetary sanctions, the cease and desist order, and the collateral and associational bar assessed against Mr. Malouf.

2. Award of sanctions is based on improper finding of recklessness

The ALJ's award of sanctions, including both monetary sanctions and the cease and desist order, are based on the above-discussed finding of recklessness. *See* Section D, above. Because the finding of recklessness should be reversed, the award of sanctions based on that finding should be reversed as well.

3. Award of sanctions relies on excluded expert testimony.

The ALJ also based his award of sanctions against Mr. Malouf on Mr. McGinnis' testimony that he had "never seen a million dollars conflict of interest like this before." Initial Decision p. 41. This reliance was wholly improper and contrary to the ALJ's own evidentiary ruling.

Mr. Malouf objected to the introduction of Mr. McGinnis' testimony, which was not presented live in this action but, instead, was testimony presented in a separate state court proceeding between Mr. Malouf and Mr. Kopczynski. In allowing the testimony into the record, the ALJ ruled:

> I allowed in the testimony [of Mr. McGinnis] noting that I would not base any part of the ruling on McGinnis' opinions to the detriment of Malouf and would not rely on his opinions to shore up the Division's expert testimony. My ruling during the hearing

> remains unchanged; I am not replying on McGinnis' opinions in any way...."

Initial Decision p. 34.

The ALJ's award of a Cease and Decision order based on McGinnis' testimony from the separate State Court action is, therefore, improper and unfounded. The ruling should be reversed and the cease and desist order denied.

4. The award of sanctions is unjustified under the *Steadman* factors.

The appropriateness of any sanction is guided by the public interest factors set forth in *Steadman v. S.E.C.* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) ("Steadman factors").

> (1) the egregiousness of the respondent's actions;
>
> (2) the isolated or recurrent nature of the infraction;
>
> (3) the degree of scienter involved;
>
> (4) the sincerity of the respondent's assurances against future violations;
>
> (5) respondent's recognition of the wrongful nature of his or her conduct; and
>
> (6) the likelihood that the respondent's occupation will present opportunities for future violations.

Other factors that have been considered include:

> (7) the age of the violation (*Marshall Melton, 56 S.E.C.* 695, 698 (2003));
>
> (8) the degree of harm to investors and the marketplace resulting from the violation (*Id.*);
>
> (9) the extent to which the sanction will have a deterrent effect (*Schield Mgmt. Co.,* Exchange Act Rel. No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862); and
>
> (10) whether there is a reasonable likelihood of violations in the future (*KPMG, 54 S.E.C.* 1135, 1191 (2001)).

The Commission weighs these factors in light of the entire record. No one factor is dispositive. *Id.*

Here, assuming that the Commission upholds the ALJ's finding that a violation occurred, the Steadman Factors weigh against the imposition of sanctions. As stated in Section D, above, there is no indication that Mr. Malouf acted with scienter, or with any evil intent whatsoever. To the contrary, at all times he believed he and the Firm were in compliance with the applicable rules and requirements. In order to ensure compliance, Mr. Malouf (1) appointed an experienced and knowledgeable CCO and (2) retained experienced and reputable outside compliance consultant to advise him (and the Firm) as to the propriety of their filings – actions indicative of a person acting in good faith.

Additionally, there is no likelihood of future violations. Immediately after Mr. Malouf learned that the disclosure was absent, he revised the Form ADV to disclose the existence of a potential conflict.

Moreover, in this case, there is no customer harm. Any warranted remedial and punitive measures that could reasonably be attributed to the conduct at issue has been satisfied. On or around May 14, 2014, UASNM entered into a settlement with the SEC in which it agreed to pay $506,083.74 to customers for purportedly excessive commissions, along with a $100,000 civil penalty. (FOF 311). Mr. Malouf paid 100% of those amounts, fully compensating customers for the amounts the Division contends here (again) they were overcharged. Any customer harm has been remedied and, even before the Division instituted this proceeding, those customers were made whole.

Under the above factors, the assessment of a sanction is not in the public interest, and the sanctions imposed by the ALJ should be reversed.

F. The Initial Decision Ignored Mr. Malouf's Bona Fide Inability To Pay.

1. The ALJ overvalued NM Wealth Management.

The ALJ ignored evidence of Mr. Malouf's inability to pay an award of disgorgement, interest, or civil penalties. Mr. Malouf supplied a Brief in Support of Inability to Pay Disgorgement, Interest or Penalties, in which he calculated that his liabilities exceeded his assets by approximately $634,000. Yet, in issuing an award of sanctions, the ALJ substituted his own approximations for those set forth, with evidentiary support, by Mr. Malouf. For example, the ALJ recalculated the value of his current business, NM Wealth Management, assessing it a value of over $300,000 (compared to Mr. Malouf's estimate of $100,000). While the evidence presented by Mr. Malouf supports his valuation of the business, opposed to the value arbitrarily assigned by the ALJ, the focus on the value is moot if the award of an industry bar is upheld.

The ALJ's valuation of NM Wealth Management was based on a multiple of the past revenues earned. If, however, Mr. Malouf was barred from the industry, his business will be unable to operate and NM Wealth Management's revenues would be $0. Mr. Malouf is the sole investment adviser at the company and an industry bar would foreclose its ability to earn any revenue whatsoever. In that circumstance, the value of NM Wealth Management would be an estimated $7,500 (the value of the tangible assets owned), as opposed to the $292,500 estimated by the ALJ (based on the Firm's projected, but not attainable, revenue).

2. Regardless of the value assigned to NM Wealth Management, Mr. Malouf is unable to pay any monetary penalty.

Regardless of which valuation is used, both Mr. Malouf's calculation and the ALJ's determined that Mr. Malouf has a negative net worth and is unable to pay a civil penalty. Mr. Malouf's assets are few and those he has are illiquid, meaning they could not be liquidated

in order to pay a civil penalty. There is also little left of Mr. Malouf's monthly income after expenses, leaving him nothing to pay off a civil penalty.

Further, any computation of Mr. Malouf's ability to pay must take into account the fact that he is (currently) barred from working in the only career he has ever known. As the ALJ acknowledged in the Initial Decision, Mr. Malouf proved that:

> [G]iven his present financial status, he has dramatically less ability to pay any more substantial sums of money. The collateral bar I have ordered will deprive him of his ability to work in his chosen profession as his liabilities exceed his available assets.

Initial Decision p. 47. Despite recognizing this inability to pay, the Initial Decision awarded a $75,000 civil penalty, on the basis that he is "an individual of aptitude and shrewdness who will undoubtedly find work in some other business profession." Initial Decision p. 46. The ALJ's conclusion, based entirely on the ALJ's hopes and suppositions, disregards the uncontroverted evidence of Mr. Malouf's financially dire situation.

To the extent the Commission upholds the ALJ's order instituting an industry bar, it should reverse the civil penalty awarded on the grounds that Mr. Malouf is unable to pay that award.

3. Mr. Malouf has already paid $506,083 in restitution.

Additionally, in issuing the $75,000 fine, the ALJ failed to take into account the fact that Mr. Malouf has already paid investors $506,083 in restitution for the conduct alleged in the Order Instituting Proceedings. FOF 311. Although the ALJ considered Mr. Malouf's prior payments in determining whether disgorgement was warranted (properly concluding it was not), it did not factor those payments into his civil penalty analysis.[19] To the extent liability is upheld on the underlying charges, the civil penalty assessed against Mr. Malouf should take into account

[19] Other than to compare the $75,000 fine awarded here to the $100,000 amount already paid, the ALJ simply noted the fact that this fine was lower than the previous fine.

the amounts he has already paid to date. Specifically, the ALJ concluded that Mr. Malouf was responsible for $442,106 of the purported losses suffered by his clients. Mr. Malouf has already paid over $506,000 to compensate his clients ($63,977 over the amount for which he is supposedly responsible). In addition, he has paid $100,000 in civil fines on behalf of the Firm. FOF 371.

Accordingly, to the extent liability is found, Mr. Malouf should not be ordered to pay any additional civil penalty.

IV. CONCLUSION

Based on the facts and authority set forth herein, Mr. Malouf respectfully requests that the Commission:

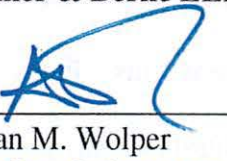
(1) Reverse the findings and conclusions in the Initial Decision that Mr. Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c) and Advisers Act Sections 206(1) and (2); 206(4) and 206(4)-1(a)(5) and Section 207;

(2) Reverse the finding of aiding and abetting liability; and

(3) Vacate the award of sanctions, including the Cease and Desist Order, Civil Monetary Penalty, and Industry Bar.

Respectfully submitted this 1st day of September, 2015.

Ulmer & Berne LLP



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CERTIFICATE OF SERVICE

I hereby certify that the attached **RESPONDENT'S BRIEF IN SUPPORT OF PETITION FOR REVIEW** has been sent to the following parties entitled to notice as follows:

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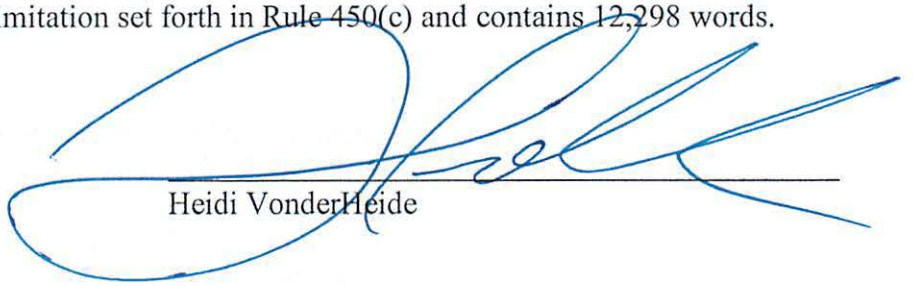
This 1st day of September, 2015.

Alan M. Wolper

CERTIFICATION

I, Heidi VonderHeide, counsel for Respondent Dennis Malouf, hereby certify that this brief complies with the length limitation set forth in Rule 450(c) and contains 12,298 words.



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